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No. _____

In The

SUPREME COURT OF THE UNITED STATES

October Term 1998

GARY LOVENESS and ELIZABETH LOVENESS,

Petitioners

v.

STATE OF ARIZONA, ex rel.
ARIZONA DEPARTMENT OF REVENUE,

Respondent

On Petition for Writ of Certiorari
To the Arizona Court of Appeals, Division One

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989), overrule *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980), which found the federal Indian timber laws (25 U.S.C. §§ 196, 406, and 407 and 25 C.F.R. § 163) to preempt state gross income and excise taxes on non-Indian loggers for tribal timber enterprises?

2. Does the off-reservation domicile of the non-Indian logger, which did not prevent federal preemption of state gross income taxes in *Bracker,* defeat preemption of net income taxes on the same logger under the same federal regulatory scheme?

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PETITION FOR WRIT OF CERTIORARI

Gary Loveness and Elizabeth Loveness respectfully petition for a writ of certiorari to review the judgment of the Arizona Court of Appeals, Division One, entered in this case on January 22, 1998.

OPINION BELOW

The opinion of the Arizona Court of Appeals is reported at 192 Ariz. 224, 963 P.2d 303 (App. 1998). Appendix ("App.") 1. The Arizona Supreme Court's order denying review is unreported. App. 15. The Arizona Tax Court's judgment and minute entry order are unreported. App. 16-24.

STATEMENT OF JURISDICTION

On January 22, 1998, the Arizona Court of Appeals, Division One, entered the judgment from which review is sought. On September 24, 1998, the Arizona Supreme Court denied the timely petition for review. App. 15. This petition is filed within 90 days of September 24, 1998. Jurisdiction is conferred on this Court by 28 U.S.C. § 1257.

STATUTORY AND REGULATORY PROVISIONS

The Appendix contains the pertinent portion of the Arizona Income Tax Act, Ariz. Rev. Stat. § 43-1011, and the federal Indian timber laws and regulations, 25 U.S.C. §§ 196, 406, and 407 (App. 31-35), and 25 C.F.R. §163 (App. 36-79.)

STATEMENT OF THE CASE

A. Prior Proceedings and Proceedings Below.

This Court held in *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980), that comprehensive federal statutes and regulations governing the management, harvest, and sale of Indian timber implicitly preempt state gross

income and motor fuel taxes on non-Indian contractors hauling timber for a tribal enterprise. The non-Indian logger in the *Bracker* case was Basin Building Materials Company, an Oregon corporation doing business as "Pinetop Logging Company." Gary and Elizabeth Loveness, husband and wife, are the sole shareholders of Pinetop Logging Company. Facts ¶ 2.[1]

In its annual tax returns after the *Bracker* decision in 1980, Pinetop Logging Company claimed immunity from both the gross income taxes specifically at issue in the *Bracker* litigation and Arizona net income tax on its profit from its logging activities for the White Mountain Apache Tribe. Facts ¶¶ 10 and 12. Though sometimes questioning those claims of preemption, for ten years the Arizona Department of Revenue did not attempt to collect any such taxes. Facts ¶ 13.

In 1986 Petitioners elected to convert Pinetop Logging Company to a Subchapter S corporation, with the result under both federal and Arizona income tax laws that income previously recognized at the corporate level passed through to the shareholders with the same tax character. 26 U.S.C. § 1366(a); Ariz. Rev. Stat. § 43-1126. Facts ¶ 3. In 1988 Petitioners retired and ceased the operations of Pinetop Logging Company. Facts ¶ 4. The equipment and machinery of the company was sold in 1987 and 1988, resulting in recapture of depreciation in addition to usual operating income. Facts ¶ 8(f). From 1969 to 1988 Pinetop Logging Company was engaged in transporting tribal timber on tribal and Bureau of Indian Affairs roads on the Fort Apache Indian Reservation. The income sought to be taxed in this case was earned hauling that tribal timber on those roads. Facts 5.¶

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[1] References to "Facts" are to the undisputed Plaintiffs' Statement of Facts filed April 11, 1996, and supplemented July 3, 1996, in the Arizona Tax Court.

In 1989 this Court decided *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, which held the implied federal preemption standards which were satisfied by the Indian timber laws in *Bracker* were not satisfied by the Mineral Leasing Act of 1938. In 1990 the Arizona Department of Revenue commenced income tax proceedings against Petitioners for 1987 and 1988 taxes on the income of Pinetop Logging Company which passed through to their individual income tax returns. Facts ¶ 8(h). (Petitioners always paid Arizona income taxes on their earnings as employees of Pinetop Logging Company. The assessments involved in these proceedings relate to Petitioners' allocable shares of Pinetop Logging Company's net income from logging for the Tribe after deduction of expenses, including Petitioners' salaries. Facts ¶¶ 11 and 12.)

After Gary and Elizabeth Loveness exhausted administrative remedies before the Arizona Board of Tax Appeals (App. 25), they brought an action in the Arizona Tax Court, where they again raised the federal preemption claim in their complaint. App. 80. The Arizona Tax Court action was presented on stipulated facts which restated, essentially verbatim, the facts upon which *White Mountain Apache Tribe v. Bracker* had been decided, except for the difference in tax years. The parties further agreed globally that Pinetop Logging Company's activities were identical for relevant purposes to those in the *Bracker* case:

> The character of Pinetop Logging's activities, insofar as relevant to federal preemption of state taxation by federal timber regulation or by the doctrine against infringement of tribal sovereignty, was the same in 1986, 1987, and 1988 as it was during the time period before the state and federal courts in *Bracker*. Facts ¶ 8(f).

Nevertheless, the Arizona Tax Court rejected Petitioners' claim of federal preemption. App. 16-24. The Arizona Court of Appeals affirmed (App. 1), declining to follow *Bracker* because, it held: (1) this case involves Arizona's net income tax, not its gross income tax, and in the

case of net income taxes the off-reservation domicile of the taxpayers trumps the preemption holding of *Bracker* and (2) *Bracker* was "modified" by *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 186-87 (1989), so that the taxes in this case no longer burden the tribe enough to interfere impermissibly with the purposes of the federal Indian timber laws. App. 6-11.

The disputed taxes are $105,164.00. Facts ¶ 15 and Supp. Facts ¶¶ 16-19. The average annual assessments of gross income and motor fuel taxes which impermissibly disrupted the same federal regulatory scheme in *Bracker* were about $7,000.00 combined. Facts ¶ 8(e).

B. Additional Facts.

A principal factor considered by both Pinetop Logging Company and the Tribe in negotiating contract prices for logging was the cost and return to Pinetop Logging Company from its operations for the Tribe, including the effect of taxes. The State originally agreed in 1969 that it had no jurisdiction to tax Pinetop Logging Company's activities for the Tribe, and its contracts therefore contained no provisions shifting the burdens of any taxes to the Tribe. Facts ¶ 8(a). In 1971 the State reversed position, leading to the *Bracker* litigation. In 1973 the Tribe indemnified Pinetop Logging Company, at Pinetop's insistence, for the disputed taxes accruing in the future, but not for earlier periods. Pinetop Logging Company had the practical ability to negotiate that indemnification for future taxes because it had ongoing business dealings with the Tribe and the Tribe desired to continue contracting for its logging services. Facts ¶ 8(c). After the *Bracker* decision in 1980, the contracts between Pinetop Logging Company and the Tribe omitted all tax indemnification, as it was thought unnecessary in light of the *Bracker* decision, just as it had been thought unnecessary in 1969. Facts ¶ 8(d).

The income tax assessments at issue in these proceedings were made in 1990, two years after Petitioners terminated their business relationship with the Tribe and thus

lost the business context to obtain indemnification from the Tribe. Facts ¶ 8(h).

The timber resource is of great importance throughout Indian country. The *Final Report of the American Indian Policy Review Commission* (1977), a two-year Congressional study, summarized the importance of timber to many Indian peoples:

> Timber has the potential for being one of the most important Indian resources for development of reservation economies.
>
> . . .
>
> The economic potential of Indian timber resources is very encouraging. Indeed, it is estimated that tribes possessed of medium to large stands of timber have the capacity to achieve economic self-sufficiency based on their timber resources alone for, as cannot be overemphasized, timber is a renewable resource. With proper management and with the development of related industry, it can supply an economic base for certain tribes for the indefinite future.

Id. at 324, 327. The *Final Report* also shows the quantitative importance of timber resources to many tribes:

> One-fourth of all Indian lands are forested, and 10 percent of all Indian lands are commercial forest lands. Timber contributes from 25 to 100 percent of tribal revenues for 57 reservations; more than 80 percent on 11 of these reservations. . . .

Id. at 324. However, the Congressional commission also concluded that the potential benefits from Indian timber had not been achieved, in large part because of the Bureau of Indian Affairs' lack of success at comprehensive planning and management of the resource. *Id.* at 324-28.

The *Bracker* decision established 18 years ago the independence of tribal forestry programs from state taxes,

including when tribes employ non-Indian contractors in their programs. The Opinion below challenges that protection for the 57 tribes with commercial timber resources.

REASONS TO GRANT THE PETITION

I. THIS COURT HAS THE EXCLUSIVE PREROGATIVE TO DECIDE THAT ITS PRECEDENTS HAVE BEEN OVERRULED.

The same lower court which this Court's judgment reversed in 1980 now holds that judgment no longer binding because this Court later "modified" its 1980 precedent. The court below holds that supposed modification sufficient to change the outcome in this renewed litigation between essentially the same parties on the same or virtually the same legal issues.

A. The Opinion Below Held *Bracker* Overruled.

1. Twenty years ago the Arizona Court of Appeals held the federal Indian timber laws not to preempt gross income and motor fuel taxes on Pinetop Logging Company because that court "doubt[ed] that the combined annual . . . tax of $9,000.00 assessed against Pinetop is going to seriously interfere with the tribe's objectives". *White Mountain Apache Tribe v. Bracker*, 120 Ariz. 282, 290, 585 P.2d 891, 899 (App. 1978). This Court reversed on that very point, finding that specifically economic purposes of the federal regulation were impermissibly disrupted by those taxes falling immediately on the Tribe's non-Indian logger:

> In these circumstances we agree with petitioners that the federal regulatory scheme is so pervasive as to preclude the additional burdens sought to be imposed in this case. . . . There is no room for these taxes in the comprehensive federal regulatory scheme. In a variety of ways, the assessment of state taxes would obstruct federal policies. And equally important, respondents have been unable to identify

> any regulatory function or service performed by the State that would justify the assessment of taxes for activities on Bureau and tribal roads within the reservation. . . .
>
> . . .
>
> [I]t is undisputed that the economic burden of the asserted taxes will ultimately fall on the Tribe. Where, as here, the Federal Government has undertaken comprehensive regulation of the harvesting and sale of tribal timber, where a number of the policies underlying the federal regulatory scheme are threatened by the taxes respondents seek to impose, and where respondents are unable to justify the taxes except in terms of a generalized interest in raising revenue, we believe that the proposed exercise of state authority is impermissible.

White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 146, 151 (1980). Indeed, the federal Indian timber regulations (unlike the Mineral Leasing Act of 1938 at issue in *Cotton Petroleum)* state as their express purpose "that the Indians may receive from their Indian forest land . . . the benefit of all the labor and profit that such Indian forest land is capable of yielding." 25 C.R.F. § 163.3(b)(4).

Measured by the standard of *Bracker* itself and the parties' stipulation in this case that the character of Pinetop Logging's activities, insofar as relevant to federal preemption, is the same as at the time of *Bracker* (Facts 8(f)), sufficient disruption of the federal purposes is manifestly apparent. The $7,000 taxes per year on the Tribe's logger were preempted, even though they were "considered part of the cost of harvesting and marketing timber" and "amounted to less than 1% of the annual profits produced by the logging operation." *Ramah Navajo School Bd. v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 842 n. 5 (1982) (discussing *Bracker*). The taxes in this case are $105,164.00 for two years.

As is discussed below in more detail, the court below has determined that *Bracker* is no longer good law according

to its terms, even as to the preemptive effect of the federal Indian timber laws, because "since *Bracker* the Supreme Court has modified the way it analyzes possible negative financial effects on individual Indians or their tribes when a tax is challenged by non-Indians conducting on-reservation activities." App. 7-8.

2. The Arizona Court of Appeals held in 1978 (120 Ariz. at 289-90, 585 P.2d at 898-99), that the technical incidence of the tax under state law controls whether it is preempted by a specific federal regulatory scheme. This Court reversed on that very point, holding the practical effect of the tax on the federal purposes, not its technical incidence under state law, is the measure of its permissibility. 448 U.S. at 150-51. *Accord, Ramah Navajo*, 458 U.S. at 844 n. 8; *Cabazon Band of Mission Indians v. Wilson*, 37 F.3d 430, 434 & n. 1 (9th Cir. 1994); *Crow Tribe of Indians v. State of Montana*, 819 F.2d 895, 899 (9th Cir. 1987).

In 1998 the Arizona Court of Appeals revived its earlier reasoning rejected in *Bracker*. It declared that *Bracker* preemption does not apply as long as the tax is not an "activity tax" on "activities that occurred in Indian country." App. 6-8. Since the income tax is denominated by the State as "an undifferentiated tax not identified with, or a function of, any particular source of gross income," the fact that the tax is on earnings from logging for the tribe on its reservation apparently ceases to matter. App. 7-8.

3. The non-Indian taxpayer in *Bracker* was a non-resident of the reservation—indeed, it was in substance the same taxpayer as in this case. This Court has noted in *Oklahoma Tax Commission v. Sac and Fox Nation*, 508 U.S. 114, 126 (1993), that *Bracker* involved "the State's ability to tax income earned from work performed for the Tribe itself *when the employee does not reside in Indian country*." (Emphasis added.)

The Opinion below had now held that the off-reservation domicile of the non-Indian logger trumps the

preemption from federal regulation of Indian timber found in *Bracker*. App. 9-11.

B. Precedents of This Court Are Binding on Lower Courts Until This Court Holds them No Longer Controlling.

The lower court's refusal to follow this Court's prior decision until this Court judges its precedent overruled is sufficient in itself to warrant certiorari. *Thurston Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533, 535 (1983)("the Court of Appeals went on to 'doubt that *Rice* is still good law'...[n]eedless to say, only this Court may overrule one of its precedents"); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989)("If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions."); *Agostini v. Felton*, 521 U.S. 203 (1997)("We do not acknowledge, and we do not hold, that other courts should conclude our most recent cases have, by implication, overruled an earlier precedent," reaffirming *Rodriguez de Quijas*, 490 U.S. at 484); *Hutto v. Davis*, 454 U.S. 370, 374-375 (1982)("[U]nless we wish anarchy to prevail within the federal judicial system, a precedent of this Court must be followed by the lower federal courts no matter how misguided the judges of those courts may think it to be."); *Wallace v. Jaffree*, 472 U.S. 38, 47 n.26 (1985)(same).

Indeed, certiorari is compelling here, for in this case the same lower court made the same disposition with respect to the same taxpayers and the same federal regulatory scheme before its decision was reversed by this Court in *Bracker*.

Moreover, even viewed apart from the lower court's departure from judicial hierarchy, the ruling below independently warrants certiorari for its practical importance and its novelty. That decision threatens the integrity of Indian timber resources and undermines the jurisprudence of

implied preemption of state laws from comprehensive federal regulations for the benefit of Indians.

II. THE OPINION BELOW CONFLICTS WITH THE WEIGHT OF STATE AND FEDERAL DECISIONS AFTER *COTTON PETROLEUM* RECOGNIZING THE CONTINUING FORCE OF *BRACKER* AS TO THE PREEMPTIVE EFFECT OF THE FEDERAL INDIAN TIMBER LAWS.

1. The court below held that *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989), "modified" *Bracker* "by holding that typical indirect effects on federal or tribal interests *cannot by themselves* require preemption of a state tax." App. 8 (emphasis added). The Opinion below further labels it "speculation" to say net income taxes "imposed a direct economic effect on the tribe, undermined the tribe's interests, or limited federal policies" of the timber laws. App. 8-9. This challenges both the undisputed facts of record (Fact ¶ 8(f)) and the very holding and reasoning of *Bracker* in economically identical circumstances. On that view of *Cotton Petroleum*, income taxes are *per se* excluded from the preemption inquiry, whatever the magnitude of the taxes or their practical effect on the tribal timber program.

Neither Pinetop Logging Company nor Petitioners have ever contended that economic effects alone, whether indirect or direct, establish preemption without articulated federal economic purposes which "assessment of state taxes would obstruct." *Bracker*, 448 U.S. at 148. Moreover, this Court actually stated in *Cotton Petroleum* that, in contrast to the Indian timber laws, "Congress was not concerned with state taxation" and there was "no evidence . . . that Congress intended to remove all barriers to profit maximization" in the Mineral Leasing Act of 1938. 490 U.S. at 179. *Cotton Petroleum* reasserted the continuing preemption under the timber laws because of their "special factor" and the "more explicit guidance from Congress," which is absent from the Mineral Leasing Act of 1938. *Id.* at 187. The timber laws

expressly provide "the overriding federal objective of guaranteeing Indians that they will 'receive . . . the benefit of whatever profit [the forest] is capable of yielding. . . .'" *Bracker*, 448 U.S. at 149. While *Cotton Petroleum* declined to extend federal preemption to a different regulatory scheme lacking most of the elements of preemption found in *Bracker*, it reaffirmed the preemption found in *Bracker* from the timber laws.

2. The opinion below is one of two which have held that *Cotton Petroleum* overrules or modifies *Bracker* concerning the preemptive effect of the federal Indian timber laws themselves. *Blaze Construction Co. v. Taxation & Revenue Dep't.*, 118 N.M. 647, 884 P.2d 803 (1994), *cert. denied*, 514 U.S. 1016 (1995) ("New Mexico *Blaze Construction*"), decided, correctly in Petitioners' opinion, that *Bracker* preemption of state taxes on tribal contractors cannot be imported into the law of federal contractors as a new barrier to state taxes. Despite the correctness and sufficiency of its conclusion that "the Indian preemption doctrine is inapplicable" to federal contractors, 884 P.2d at 806, New Mexico *Blaze Construction* unnecessarily stated further that *Cotton Petroleum* "abandoned" the requirement of *Bracker* "that the state's general interest in raising revenue through taxes was not sufficient justification for imposing the tax" in a case otherwise federally preempted. 884 P.2d at 808. The opinion below embraces that conclusion. App. 8-11.

If general justification of state taxation is sufficient to defeat implied Indian preemption of state taxes, then such preemption is now a dead letter. States can always justify taxation with a general need for revenues. But that jurisprudential universe did not come to an end in 1989, for *Cotton Petroleum* only rejected the notion that lack of proportional benefits *alone* invalidates state taxes on tribal contractors. "[W]e decline to return to this long-discarded and thoroughly repudiated doctrine." *Cotton Petroleum*, 490 U.S. at 187.

The Mineral Leasing Act of 1938, unlike the timber laws, was found at the threshhold not to be preemptive. *Id.* at 176-83. "Congress was not concerned with state taxation," and there was "no evidence for the further supposition that Congress intended to remove all barriers to profit maximization." 490 U.S. at 179-80. The non-Indian taxpayer in *Cotton Petroleum* was left with no argument but disproportionality of state taxes and state benefits, and that argument failed.

3. All other cases recognize the continuing vitality of *Bracker* and the strong preemptive effect of the federal Indian timber laws. *Hoopa Valley Tribe v. Nevins*, 881 F.2d 657 (9th Cir. 1989), *cert. denied*, 494 U.S. 1055 (1990), decided after *Cotton Petroleum,* held a California timber yield tax, as applied to the first non-exempt buyer of tribal timber, preempted by the federal Indian timber laws. California attempted to distinguish *Bracker* on the basis that California provided governmental services to the off-reservation non-Indian buyer and to Indians. Noting that this Court had rejected that very argument in *Ramah Navajo*, the Ninth Circuit observed that "none of those services is connected with the timber activities directly affected by the tax. . . . Showing that the tax serves legitimate state interests, such as raising revenues for services used by tribal residents . . . is not enough. . . . Because the timber yield tax does not fund services that directly relate to the harvesting of tribal timber and is otherwise unconnected with tribal timber activities, the timber yield tax should be preempted" *Id.* at 661. *Accord, In re Blue Lake Forest Products, Inc.*, 30 F.3d 1138, 1142 (9th Cir. 1994), *cert. denied sub nom. Hong Kong and Shanghai Banking Corp., Ltd v. Hoopa Valley Tribe*, 513 U.S. 1059 ("we note that federal interests are very extensive and normally prevail over state interests in the regulation of timbering on Indian reservations").

Gila River Indian Community v. Waddell, 967 F.2d 1404, 1408 (9th Cir. 1992), confirmed that the objective of the federal Indian timber laws' is "assuring Indian tribes the greatest benefit possible from the harvest of their forests,"

and that exacting "any sort of monetary concession from those conducting logging activities in the Tribe's forest would have necessarily impinged on the profits reaped by the Tribe in connection with those activities."

Other appellate court cases after *Cotton Petroleum* continue to recognize *Bracker's* requirement that state taxes intruding into tribal timber programs must be carefully tailored to regulatory services provided. *E.g., Cabazon Band of Mission Indians v. Wilson*, 37 F.3d 430, 435 (9th Cir. 1994) ("100% of the license fee earned from Indian wagering goes into the State General Fund. This suggests a 'distant,' rather than a carefully tailored, relationship between the license fee revenue and the regulatory services provided thereunder."); *Hoopa Valley Tribe v. Nevins*, 881 F.2d 657, 661 (9th Cir. 1989).

The income taxes the State asserts in this case also go entirely into the general fund. They have no relationship whatever, much less a "carefully tailored relationship," to any state services to the tribal timber enterprise in which, or the tribal and BIA roads on which, the income is earned.

The "modification" of *Bracker* found by this panel of the Arizona Court of Appeals cannot be squared with the discussion of *Bracker* by another panel of that same court in *State v. Blaze Construction Co.*, 190 Ariz. 262, 947 P.2d 836 (App. 1997), ("Arizona *Blaze Construction*"), *cert. granted*, 118 S.Ct. 1793 (1998). Arizona *Blaze Construction* stated that *Bracker* "articulated the modern formulation of the Indian law pre-emption analysis" and the federal regulations "amount to a comprehensive federal scheme into which state taxing authority may not intrude." *Id.* at 267, 268, 947 P.2d at 841, 842. Arizona *Blaze Construction* specifically held, erroneously in Petitioners' opinion, that *Bracker* preemption of taxes on tribal contractors can be read into the law of state taxation of federal contractors as well. The error of that specific holding does not detract from the vitality of timber law preemption as to tribal contractors

Even the cases which find no preemptive regulatory scheme do so after applying the *Bracker* analysis without questioning its continuing validity. *E.g.*, *Northern Border Pipeline Co. v. State*, 237 Mont. 117, 121-28, 772 P.2d 829, 831-35 (1989) (*Bracker* is the "seminal case" regarding the preemptive effect of federal regulatory schemes in Indian law); *Salt River Pima - Maricopa Indian Community v. Arizona*, 50 F.3d 734, 736-39 (9th Cir. 1995); *Anderson v. Wisconsin Dept. of Revenue*, 169 Wis.2d 255, 262-76, 484 N.W.2d 914, 916-22 (1992).

III. THE HOLDING THAT OFF-RESERVATION DOMICILE DEFEATS PREEMPTION WHICH MAY OTHERWISE BE MANDATED BY SPECIFIC FEDERAL REGULATORY SCHEMES FOR THE BENEFIT OF INDIANS CONFLICTS WITH THE DECISIONS OF THIS COURT.

The opinion below raises another novel and fundamental challenge to the jurisprudence of implied preemption of state taxes from comprehensive federal regulations for the benefit of Indians by holding that such preemption ceases to matter if the non-Indian agent of the tribe chosen by the State as the object of its taxes is domiciled outside Indian country. App. 9-11.

This novel theory conflicts with both the practice and the articulation Indian preemption doctrine in this Court and in the lower courts. As has been noted, *Oklahoma Tax Commission v. Sac and Fox Nation*, 508 U.S. 114, 126 (1993), observed that *Bracker* itself had involved "the State's ability to tax income earned from work performed for the Tribe itself when the employee does not reside in Indian country." *Bracker's* companion case of *Central Machinery Co. v. Arizona State Tax Commission*, 448 U.S. 160 (1980), held Arizona gross income taxes preempted by federal regulation of a non-Indian trader not licensed or required to be licensed by the Bureau of Indian Affairs and whose sole place of business was off-reservation. In *Ramah Navajo*

School Bd. v. Bureau of Revenue of New Mexico, 458 U.S. 832, 843-44 & nn. 7-9 (1982), the Court ruled that gross income taxes on non-Indian, off-reservation construction firms derived from building schools for the tribe were preempted by a federal regulatory scheme for Indian education, expressly rejecting an argument that the non-Indian contractors' off-reservation residence and the State's "services to [the non-Indians] . . . off the reservation" trump preemption.

In many of the lower court cases of implied preemption, the non-Indian taxpayer was domiciled off the reservation. *E.g., Cabazon Band of Mission Indians v. Wilson*, 37 F.3d 430 (9th Cir. 1994) (organization of racing associations whose presence and activities were entirely off-reservation except for the activities which occasioned the preempted tax); *In re Blue Lake Forest Products, Inc.*, 30 F.3d 1138 (9th Cir. 1994) (preempting state commercial law principles to defeat an off-reservation bank's security interest in tribal timber transported off-reservation); *Herzog Brothers Trucking, Inc. v. State Tax Commission*, 72 N.Y.2d 720, 533 N.E.2d 255, 536 N.Y.S.2d 416 (1988) (federal Indian trader regulations preempt New York gasoline taxes on off-reservation Pennsylvania wholesale distributor selling to reservation retailer); *Crow Tribe of Indians v. State of Montana*, 819 F.2d 895, 898 (9th Cir. 1987), *aff'd sub nom. Montana v. Crow Tribe of Indians*, 484 U.S. 997 (1988)(coal mining on the reservation by national mining companies); *Kenyon v. Karber Construction Co.*, 144 Ariz. 576, 698 P.2d 1295 (App. 1985) (gross income taxes preempted for off-reservation non-Indian contractor and sub-contractor for construction performed on-reservation for the tribe).

Oklahoma Tax Comm'n v. Chickasaw Nation, 515 U.S. 450 (1995), did not authorize states to tax on-reservation income of non-Indians domiciled off-reservation in disregard of specific preemptive federal regulatory schemes. *Chickasaw* restated the fall-back principle that "if the legal incidence of the tax rests on non-Indians, no categorical bar prevents enforcement of the tax; if the balance

of federal, state, and tribal interests favors the State, *and federal law is not to the contrary*, the State may impose its levy . . . ." 132 L.Ed.2d at 409 (emphasis added). Similarly, *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989), while stating that a state may generally tax non-members living off the reservation who do business with a tribe, also reaffirmed that such power may be removed by federal preemption. It specifically reaffirmed the correctness of *Bracker* concerning the preemptive effect of the timber laws, as noted above.

The opinion below introduces off-reservation residence by the non-Indian included in the federally preempted tribal activity as a new—and fatal—consideration in specific preemption cases. Heretofore, residence had no relevance to preemption by a specific comprehensive regulatory scheme. The fall-back rule allowing state taxes on off-reservation non-Indians did not trump specific preemption; specific preemption trumped the fall-back rule. If it is to be otherwise, many of the specific preemption cases willbe undermined. This far-reaching proposition merits review by this Court for many of the same reasons that prompted the Court to grant certiorari in 1980.

CONCLUSION

For the foregoing reasons, the Petition of Writ of Certiorari should be granted.

Respectfully submitted,

December 22, 1998

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APPENDIX

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APPENDIX A

IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

GARY LOVENESS AND ELIZABETH LOVENESS, husband and wife,	)	1 CA-TX 97-0003
	)	DEPARTMENT T
Plaintiffs-Appellants,	)	
v.	)	OPINION
STATE OF ARIZONA, ex rel., ARIZONA DEPARTMENT OF REVENUE,	)	[Filed: January 22, 1998]
Defendant-Appellee.	)	

Appeal from the Arizona Tax Court

Cause No. TX 94-00998

The Honorable William J. Schafer, III, Judge

AFFIRMED

Bryan Cave LLP
by Neil Vincent Wake
Robert C. Van Voorhees
Attorneys for Plaintiffs-Appellants Phoenix

Grant Woods, Attorney General
by Patrick Irvine, Assistant Attorney General
Attorneys for Defendant-Appellee Phoenix

WEISBERG, Judge

¶1 Gary and Elizabeth Loveness ("taxpayers") appeal from a summary judgment granted in favor of the Arizona Department of Revenue ("DOR") on taxpayers' claim for a partial refund of their Arizona income taxes. The taxes at issue arose out of services performed by taxpayers on an Indian reservation in Arizona. They argue that DOR's assessment of a tax on their personal net income, which arose out of on-reservation logging services, was invalid under the Supremacy Clause of the United States Constitution because it:

1. was preempted by the comprehensive federal regulation of on-reservation logging, *see White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980); or

2. infringed on the right of reservation Indians to make their own laws and be ruled by them, *see Williams v. Lee*, 358 U.S. 217 (1959).

We disagree with taxpayers and affirm.

FACTUAL AND PROCEDURAL BACKGROUND

¶2 The taxpayers are non-Indians who lived in Arizona outside the boundaries of the Fort Apache Indian Reservation ("Reservation") during the relevant period. They were the sole shareholders of Basin Building Materials, Inc., which did business as Pinetop Logging Company ("Pinetop") during 1987 and 1988.

¶3 The Reservation is the preserve of the White Mountain Apache Tribe ("the tribe") and consists of approximately 1.64 million acres in the White Mountains. This area includes about 720,000 acres of commercial forest,

of which about 300,000 acres are managed with selective cutting on a sustained yield basis.

¶4 The tribe manages, harvests, mills and sells timber as the Fort Apache Timber Company ("FATCO"). The tribe's timber operation is its most important economic activity. Subject to U.S. Bureau of Indian Affairs ("BIA") supervision, FATCO is responsible for the tribe's timber operation.

¶5 BIA representatives designate the trees that are to be cut on the Reservation. The tribe's contractors cut the trees and transport the logs to FATCO's sawmill. FATCO employees then sort the logs and process them into lumber and pulpwood. Although the tribal government owns and manages the timbering operation on the Reservation, it cannot disburse any profits without first satisfying outstanding obligations to the United States government and obtaining BIA's approval.

¶6 BIA's supervision and control over timbering practices on Indian reservations extended to all activities of FATCO and its contractors during the relevant period. *See generally* 25 U.S.C. §§ 405-07; 25 C.F.R. § 163; 36 C.F.R. § 200; *Bracker,* 448 U.S. at 13839, 145-49. The BIA head forester in charge of the Reservation described BIA's supervision as "encompassing all aspects of forest utilization and management, including extensive rules and regulations governing in detail the planning, engineering, construction, maintenance and general regulation of all roads used by loggers."

¶7 FATCO delegates certain portions of the tribe's timber operation to companies like Pinetop. From 1969 through 1988, Pinetop conducted logging operations on the Reservation under contract with the tribe. Pinetop maintained its business office, assets, and business operations on the Reservation. Pinetop owned the trucks and equipment it used in the FATCO logging operation. Over half its

employees were members of the tribe. Before Pinetop contracted with the tribe to do this work, it was advised by a representative of DOR's predecessor agency that the agency had no jurisdiction over its proposed transactions, either as to sales tax on timbering or use tax on equipment brought onto the Reservation.

¶8 In 1971, the Arizona Highway Department and Arizona Highway Commission assessed delinquent motor carrier license and fuel taxes against Pinetop. Pinetop disputed their authority to do so. Ultimately, the United States Supreme Court resolved the controversy, finding that the state taxes were preempted. The Court said:

> Where, as here, the Federal Government has undertaken comprehensive regulation of the harvesting and sale of tribal timber, where a number of the policies underlying the federal regulatory scheme are threatened by the taxes respondents seek to impose, and where respondents are unable to justify the taxes except in terms of a generalized interest in raising revenue, we believe that the proposed exercise of state authority is impermissible.

Bracker, 448 U.S. at 151.

¶9 In December 1986, taxpayers converted Pinetop into a Subchapter S corporation for federal and state tax purposes. The effect of a "Sub S" election is to end taxation of corporate net income and tax it as the personal net income of shareholders. *See* I.R.C. § 1361 (1994). Pinetop's activities on the reservation continued through 1988, when taxpayers retired.

¶10 For tax years 1987 and 1988, taxpayers received salaries from Pinetop on which they reported and paid federal and Arizona income taxes. They also reported and paid federal income taxes on Pinetop's net income, which

included ordinary income, interest income, and recapture of accelerated depreciation.[1] *See* I.R.C. § 1231. However, in their Arizona resident income tax returns for both years they subtracted Pinetop's net income, which had flowed through to them, in arriving at Arizona taxable income, stating that those sums were immune from Arizona income taxation "by virtue of preemptive federal regulations of harvest of Indian timber," citing *Bracker*.

¶11 DOR audited taxpayers' individual Arizona income tax returns for 1987 and 1988. In 1990, DOR determined that taxpayers had incorrectly subtracted Pinetop's net income in calculating their Arizona taxable income and proposed to assess corresponding income tax deficiencies against them.[2] After exhausting their administrative remedies, taxpayers commenced this action in the tax court under A.R.S. sections 42-124(C) and (D).

¶12 On cross-motions for summary judgment the tax court distinguished the instant case from *Bracker*. It found that the motor vehicle registration and use fuel excise taxes were different from the general income tax applied here because the former had taxed on-reservation activity and reduced both tribal revenues from timber sales and tribal contractors' potential profits.

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[1] In 1987 and 1988, as now, Arizona Revised Statutes Annotated ("A.R.S.") section 43-1001(2) (1980 and Supp. 1997) defined "Arizona gross income" of a resident individual as his/her federal adjusted gross income for the taxable year. All sums reported as gross income of the taxpayer for federal income tax purposes would therefore be reflected, as adjusted by other additions and subtractions provided by federal law, in his/her Arizona gross income for the same taxable year.

[2] The income tax deficiencies DOR sought against taxpayers were based on the addition of $567,039 to the taxpayers' 1987 taxable income and $1,196,838 to that for 1988.

¶13 The tax court found that, in this case, the individual income tax did not tax on-reservation activity, did not burden the tribe or its members, and did not reduce either tribal revenues from timber sales or potential profits of trib contractors. It also found that taxpayers had not explained how imposing the Arizona individual income taxes on non-Indian, non-residents who earned the income on an Indian reservation infringed upon the right of tribal self-government. It therefore granted summary judgment for DOR.

¶14 Taxpayers bring this timely appeal, which is assigned to Department T of this court pursuant to A.R.S. sections 12-120.04(G) and 12-170(C).

DISCUSSION

Applicability and Effect of *Bracker*

¶15 Both sides agree that the relevant facts are identical to those in *Bracker* except for one: the tax challenged here is Arizona's resident individual income tax, not its motor carrier registration or use fuel tax, we must decide whether this difference changes the *Bracker* analysis and compels a different result. We conclude that it does.

¶16 The motor carrier registration tax and use fuel tax that were challenged in *Bracker* were activity taxes (i.e. taxes that are assessed for conducting an activity). *Id.* at 139-40. The motor carrier license tax was imposed on all common motor carriers of property and the use fuel tax was assessed for using a motor vehicle on Arizona highways. *See id.* Both taxes are assessed regardless of the income/profit related to the activity and are a cost of doing business. *See id.*

¶17 By contrast, Arizona's resident income tax is an undifferentiated tax not identified with or a function of, any

particular source of gross income. *See* A.R.S. §§ 43-1001(1) & (2). This type of tax is an equitable way of distributing the burdens of government and is directly related to the ability of the taxpayer to pay it. *See New York ex ref. Cohn v. Graves,* 300 U.S. 308, 313 (1937). Related and unrelated exemptions and deductions covering the entire taxable year affect the determination of taxable income for that year, and the resident's income tax liability does not vary with the source of the gross income. *See* A.R.S. §§ 43-1001(1) & (2).

¶18 Taxpayers argue that the activity taxes at issue in *Bracker,* in *Central Machinery Co. v. Arizona State Tax Commission,* 448 U.S. 160 (1980), and in a number of lower court decisions are conceptually the same as the income tax at issue here. They contend that, because these cases all involved a tax on the taxpayers' "gross income," the fact that taxpayers resided off-reservation is immaterial to the preemption analysis.

¶19 We disagree. The taxes in *Bracker,* and in all of the lower court cases upon which taxpayers rely, were taxes assessed on activities that occurred in Indian country. The character of these taxes was central to the *Bracker* Court's analysis. *See* 448 U.S. at 148, 150-51. They affected the cost of logging, impacted the federal regulatory scheme, and eventually took money away from the tribe in circumvention of Congress' intent.[3] *Id.* at 148, 151. *See also Oklahoma Tax*

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[3] The four factors cited in concluding that the application of the taxes in *Bracker* were preempted all related to the negative effect the taxes would have on the tribe. They were:

(1) the additional cost burdens the tax would interpose in the pervasive federal regulatory scheme for the management of tribal timber;

(2) the thwarting of the federal policy that all tribal timber sales profits benefit the tribe;

Comm'n v. Chickasaw Nation, 515 U.S. 450, 458 (1995) ("The initial and frequently dispositive question in Indian tax cases . . . is who bears the legal incidence of the tax.") These activity taxes had direct negative financial effects on the Tribe which were critical to the Court's conclusion that they constituted an assertion of state authority on the reservation and were therefore preempted by federal law. *See* 448 U.S. at 151; *see also Yavapai-Prescott Indian Tribe v. Scott,* 117 F.3d 1107, 1112 (9th Cir. 1997) (Arizona business transaction privilege taxes are enforceable on hotel restaurant and room rental receipts for on-reservation facility because tribe does not have an "active role" in contributing to the business).

¶20 Moreover, since *Bracker,* the Supreme Court has modified the way it analyzes possible negative financial effects on individual Indians or their tribe when a tax is challenged by non-Indians conducting on-reservation activities. *See Cotton Petroleum Corp. v. New Mexico,* 490 U.S. 163, 186-87 (1989); *Blaze Constr. Co. v. Taxation and Revenue Dep't,* 884 P.2d 803, 807 (N.M. 1994). In *Cotton,* the Court faced the question of whether a state could impose a severance tax on the on-reservation production of oil and gas by non-Indian lessees who were also subject to severance taxation by the tribe. The Court held that it could.

¶21 The Court distinguished *Bracker*[4] by holding that typical indirect effects on federal or tribal interests cannot by

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(3) the complicating and undermining of the Interior Secretary's ability to set fees and rates for harvesting and selling tribal timber as federal law required him to do; and

(4) the hindering of the tribe's ability to comply with federal sustained-yield management policies.

448 U.S. at 148-49.

[4] *See also Ramah Navajo School Bd., Inc. v. Bureau of Revenue,* 458 U.S. 832 (1982).

themselves require preemption of a state tax. *See Cotton,* 490 U.S. at 186-87. The Court stated:

> It is, of course, reasonable to infer that the New Mexico taxes have at least a marginal effect on the demand for on-reservation leases, the value to the Tribe of those leases, and the ability of the Tribe to increase its tax rate. Any impairment to the federal policy favoring the exploitation of on-reservation oil and gas resources by Indian tribes that might be caused by these effects, however, is simply too indirect and too insubstantial to support Cotton's claim of preemption. To find preemption of state taxation in such indirect burdens on this broad congressional purpose, absent some special factor such as those present in *Bracker* . . . . would be to return to the pre-1937 doctrine of intergovernmental tax immunity.

Id. Thus, for a state tax to be preempted by federal or tribal law it must have more than an indirect effect on the federal regulatory scheme. *See id.*

¶22 No support beyond speculation exists for the view that any part of the income taxes assessed here imposed a direct economic effect on the tribe, undermined the tribe's interests, or limited federal policies advancing the comprehensive regulatory scheme pertaining to tribal timber harvesting and management. *Cf. State v. Blaze Constr. Co.,* 242 Ariz. Adv. Rep. 3, 9 (App. Apr. 29, 1997) (holding Arizona contracting transaction privilege tax preempted by comprehensive federal regulatory scheme identified in *Bracker* as applied to taxpayer who contracted with BIA to construct on-reservation roads used by tribal members). Thus, the difference in the tax assessed is significant enough to distinguish this case from *Bracker.*

Arizona's Authority to Tax Resident Income

¶23 In the instant case, the State assessed a general income tax on the income of non-tribal members residing off the reservation. The Supreme Court recently held that a tax on the income of tribal members working for a tribe, but residing within the State outside Indian country, is not federally preempted. *See Chickasaw Nation,* 515 U.S. at 453.

¶24 In *Chickasaw Nation,* the Chickasaw tribe had argued that the imposition of Oklahoma's income tax on tribal members employed by that tribe was a law "for the government of the [Chickasaw] Nation . . . and their descendants" that was preempted by the federal treaty with the Chickasaw Nation. *Id.* at 455. The Supreme Court disagreed. It relied on the well established principle that a jurisdiction "may tax **all the income** of its residents, even that earned outside the taxing jurisdiction," and that this principle was not preempted by the rights granted or reserved by federal law. *Id.* at 462-63 (emphasis added). It further held that:

> [T]he receipt of income by a resident of the territory of a taxing sovereignty is a taxable event . . . . Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government . . . . These are rights and privileges which attach to domicil within the state . . . . **Neither the privilege nor the burden is affected by the character of the source from which the income is derived.**

Id. at 463 (citations omitted) (emphasis added). *See also Oklahoma Tax Comm'n v. Sac & Fox Nation,* 508 U.S. 114, 124 (1993) (tribal members' liability for state income taxes depended on whether they resided inside or outside Indian country); *Graves,* 300 U.S. at 312313 (state may tax income

from rents received by a state resident from property located outside of that state).

¶25 In this case, Arizona assessed a tax on taxpayers' net income for the taxable years of 1987 and 1988. It was not assessed on a member of the tribe who resided on the reservation. *Compare Chickasaw Nation* 515 U.S. at 464 (principle that "Indians and Indian tribes are generally immune from state taxation" does not operate outside of Indian country or for non-tribal members.) It was assessed on the income of Arizona residents who were not members of the tribe and were within the State's taxing authority and is therefore a proper assessment. *See id.* at 463, 466; A.R.S. §§ 43-1001(1), (2), and § 43-1011.

¶26 Further, Congress has had the authority to change the taxability of this income if desired. *See generally Cotton,* 490 U.S. at 175; *Mescalero Apache Tribe v. Jones,* 411 U.S. 145, 148-49 (1973) (Congress can grant immunity to an Indian Tribe for all income derived from activities on the reservation). It has not done so. As a result, there is no exception from the general principle permitting taxation of those who reside within a State's jurisdiction. *See Chickasaw Nation,* 515 U.S. at 463.

Infringement on Right of Tribal Self-Government

¶27 The opinion in *Bracker* did not explore whether those taxes were invalidly imposed on the independent ground that they infringed the right of Indian nations to make their own laws and be ruled by them. *See* 448 U.S. at 143-44. In this case, however, taxpayers make that argument.

¶28 Taxpayers correctly observe that assertions of state jurisdiction on Indian reservations may improperly infringe "on the right of reservation Indians to make their own laws and be ruled by them." *Williams v. Lee,* 358 U.S. 217, 220 (1959); *cf. Bracker,* 448 U.S. at 143-44. They argue that the

reason that the tribe was contracting out logging operations was to avoid the significant capital cost of doing its own logging and that these taxes could force the tribe to undertake that cost Doing so, they argue, would drastically interfere with the tribe's judgments about the management of tribal economic affairs and business enterprises and its choices of how to invest tribal funds. *See Santa Rosa Band of Indians v. Kings County,* 532 F.2d 655, 664 (9th Cir. 1975).

¶29 Taxpayers cite *McClanahan v. Arizona State Tax Comm'n,* 411 U.S. 164, 179 (1973), for the proposition that the infringement rule is intended to test the permissible scope of state power over non-Indian aspects of transactions on reservations involving Indians and non-Indians. They rely on *McClanahan* for the proposition that the assessment of a state tax on a non-Indian related to on-reservation activity may be held infirm under the infringement doctrine when the financial burden of the tax falls on Indians. *Id.* at 170 n.6.

¶30 We acknowledge that *McClanahan's* somewhat puzzling interpretation of *Warren Trading Post Co. v. Arizona Tax Comm'n,* 380 U.S. 685 (1965),[5] was based in part on the infringement doctrine.[6] But, the infringement doctrine as now conceived by the United States Supreme Court does not apply in cases testing the legality of state taxation of non-Indians arising out of on-reservation transactions, regardless of whether the economic burden of the tax is passed along to reservation Indians. *See Duro v. Reina,* 495 U.S. 676, 686-87 (1990) ("We have held that States may not impose certain taxes on transactions of tribal

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[5] Limited by *Department of Taxation and Finance v. Milhelm Attea & Bros., Inc.,* 512 U.S. 61 (1994).

[6] Compare *McClanahan,* 411 U.S. at 170 (last full sentence) with *Warren Trading Post,* 380 U.S. at 686 (last sentence beginning on page). *Warren Trading Post* concerned Arizona retail transaction privilege taxation of a non-Indian's on-reservation sales of goods to reservation Indians.

members on the reservation because this would interfere with internal governance and self-determination . . . [b]ut **this rationale does not apply to taxation of nonmembers,** even where they are Indians.") (emphasis added) (citations omitted).[7]

¶31 We therefore conclude that taxpayers' infringement challenge is incorrect on its merits, as it principally repeats their arguments on the preemption issue, which we have already rejected.

Attorneys' Fees

¶32 Because taxpayers are not the prevailing party, we deny their request for an award of attorney's fees.

CONCLUSION

¶33 For the foregoing reasons, the judgment of the tax court is affirmed.

Sheldon H. Weisberg, Judge

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[7] *See also Washington v. Confederated Tribes,* 447 U.S. 134, 161 (1980) ("Nor would the imposition of Washington's tax on these purchasers contravene the principle of tribal self-government, for the simple reason that nonmembers are not constituents of the governing Tribe."); *Moe v. Confederated Salish & Kootenai Tribes,* 425 U.S. 463, 483 (1976). *Accord Sac & Fox Nation,* 508 U.S. at 123 *(McClanahan* immunity from state taxation extends to Indian tribal members who reside on reservation or tribal trust lands); *Pimalco, Inc. v. Maricopa County, 188* Ariz. 550, 558, 937 P.2d 1198, 1206 (App. 1997) (rejecting non-Indians' infringement doctrine challenge to ad valorem taxes on their possessory interests in Indian land). *Cf. State v. Zaman,* 254 Ariz. Adv. Rep. 8, 9 (Oct. 9, 1997) (in infringement cases question is whether state action has infringed self-governance rights of individual Indians).

CONCURRING:
Sarah D. Grant
Presiding Judge

Ruth V. McGregor, Judge

APPENDIX B

SUPREME COURT

STATE OF ARIZONA

September 28, 1998

RE: **GARY LOVENESS/ELIZABETH LOVENESS vs. STATE OF ARIZONA ex rel ARIZONA DEPARTMENT OF REVENUE**

Supreme Court No. CV-98-0179-PR
Court of Appeals No. 1 CA-TX 97-0003
Arizona Tax Court No. TX 94-00998

GREETINGS:

The following action was taken by the Supreme Court of the State of Arizona on September 24, 1998, in regard to the above-referenced cause:

ORDERED: Petition for Review = DENIED.

FURTHER ORDERED: Request for Attorneys' Fees [Appellants Loveness] = DENIED

Justice McGregor recused herself and did not participate in the determination of this matter.

Record returned to Court of Appeals, Division One, Phoenix, this 28th day of September, 1998.

NOEL K. DESSAINT, Clerk

APPENDIX C

THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN THE ARIZONA TAX COURT

GARY and ELIZABETH LOVENESS, husband and wife, Plaintiffs, vs. STATE OF ARIZONA, ex rel. the ARIZONA DEPARTMENT OF REVENUE, Defendant.	No. TX94-00998 [Filed January 13, 1997] **JUDGMENT** (Title 43) (Hon. William J. Schafer, III)

This matter came before the Court for oral argument on October 9, 1996, pursuant to the Cross-Motions for Summary Judgment filed by Gary and Elizabeth Loveness, husband and wife ("Taxpayers"), and the State of Arizona, *ex. ref.,* Arizona Department of Revenue ("Department"). Taxpayers were present at the hearing through its their counsel, Neil Vincent Wake and Robert C. Van Voorhees, Bryan Cave LLP; the Department was represented by Patrick Irvine, Assistant Attorney General. The Court, having considered the parties' briefings and argument of counsel, now finds as follows:

1. This Court has jurisdiction over these proceedings pursuant to A.R.S. §§12-163 and 42-124(B)(2);

venue in the Tax Court, in Maricopa County, is proper pursuant to A.R.S. §§12-163 and 12-165;

2. No issue of material fact exists in this case which would preclude the entry of summary judgment pursuant to Rule 56, Arizona Rules of Civil Procedure;

3. Federal law does not preempt the imposition of the Arizona state income tax on Taxpayers' income derived from Pinetop Logging Company (the business name of Basin Building Materials Co., Inc., an Oregon corporation) for tax years 1987 and 1988;

4. The imposition of the Arizona state income tax on Taxpayers' income derived from Pinetop Logging during tax years 1987 and 1988 does not offend historical notions of tribal sovereignty; and

5. Gain form the sale of equipment for Arizona tax purposes is the same as the gain shown on a taxpayer's federal return, so the gain shown on Taxpayers' 1987 and 1988 federal returns is taxable by Arizona.

Accordingly, IT IS HEREBY ORDERED as follows:

A. Taxpayers' Motion for Summary Judgment is denied.

B. The Department's Motion for Summary Judgment is granted.

SO ORDERED this 13th day of January 1997.

HON. WILLIAM J. SCHAFER, III
Judge of the Arizona Tax Court

APPENDIX D

SUPERIOR COURT OF ARIZONA

Maricopa County

No. TX 94-00998 Filed Nov 1, 1996

GARY & ELIZABETH LOVENESS	)	Neil Vincent Wake
	)	
v.	)	Attorney General
	)	By: Patrick Irvine
STATE OF ARIZONA, ex rel., ARIZONA DEPARTMENT OF REVENUE	)	

Both sides have moved for summary judgment. The issues are fairly straightforward: (1) May Arizona impose an income tax on a non-Indian who does business on the reservation but lives off the reservation, and (2) Is the gain from the sale of equipment for Arizona tax purposes the same as the gain shown on a taxpayer's federal income tax return?

The facts are also fairly straight-forward: The taxpayers owned and operated a logging company ("Basin"). In 1987, Basin logged on the White Mountain Apache Indian Reservation. In 1988, Basin went out of business and sold all its equipment. In 1987 and 1988, the taxpayers reported all of Basin's income on their federal tax returns, but subtracted from their Arizona returns the portion attributable to Basin's logging business on the White Mountain Apache Indian Reservation. The Department of Revenue examined the 1987 and 1988 returns and issued assessments for underpayment of taxes. The taxpayers protested, arguing that their income

derived from the Reservation was preempted by federal law. The protest was denied, and taxpayers appealed to the Board of Tax Appeals, which denied their appeal.

Department argues in its motion that federal law does not preempt Arizona from imposing an income tax on a non-Indian who resides outside of, but does business on, the reservation. Gila River Indian Community v. Waddell, 91 F.3d 1232 (9th Cir. 1996); Chicksaw Nation v. State of Oklahoma, 31 F.3d 964 (10th Cir. 1994), aff'd in part, rev'd in part remanded, 115 S.Ct. 2214 (1995); Sac and Fox Nation v. Oklahoma Tax Commission, F.2d 1425 (10th Cir. 1992), vacated on other grounds, 113 S.Ct. 1985 (1993); Kahn v. Arizona State Tax Commission 16 Ariz. App. 17, 490 P.2d 846 (Ct. App. 1971), appeal dismissed 411 U.S. 941 (1973).

Taxpayers argue in their response and cross motion that White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 100 S.Ct. 2578 (1980), is controlling and holds that the federal government's regulation of Indian logging activities leaves "no room" for a state tax. Accord Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico, 458 U.S. 832, 102 S.Ct. 3394 (1982).

As an alternative, taxpayers argue that even if the state income tax is not preempted, the sale of the equipment actually resulted in a tax loss for 1988. This is so, they say, because depreciation of the equipment was not accounted for on the Arizona tax schedules. When accounted for, the net result is a loss of $451,956.00 for 1988. (Pl. Resp. & Cross Mot. at 9.) The Department rejects that argument, explaining that depreciation deductions are the same for Arizona as they are for federal income tax purposes.

There are two independent but related barriers to the exercise of state taxing authority over tribal reservations and members: federal preemption and the doctrine of tribal sovereignty, neither of which bar Arizona's income tax in this case. See Bracker, 448 U.S. at 142; see also Gila River

Indian Community, 967 F.2d at 1407. And for Arizona tax purposes, the gain from the sale of equipment in 1987 is the same as the gain shown on taxpayers' federal returns.

A. Federal Law Does Not Preempt Arizona's State income Tax.

The taxpayers rely heavily on Bracker for their position that federal regulation of Indian logging preempts state taxing authority. In Bracker, Arizona sought to apply motor carrier license and use fuel taxes on two non-Indian corporations operating a logging company solely on the White Mountain Apache Reservation. See Bracker, 448 U.S. at 138. The taxes were upheld on appeal but overturned by the Supreme Court on the basis of preemption. Id.

I do not believe Bracker is controlling here. First, the tax in Bracker applied to on-reservation activity: the Court never considered whether federal preemption affected a state income tax. See generally Bracker, 448 U.S. at 136. This is an important distinction because the former tax directly burdens a primary federal objective concerning the Indians: encouraging tribal self-government. By ensuring that the tribes "retain the benefits derived from the harvesting and sale of reservation timber, the federal government encourages tribal self-government. Accordingly, the Court found that the taxes in Bracker would threaten the "overriding federal objectives of guaranteeing Indians that they will "receive ... the benefit of whatever profit [the forest] is capable of yielding ...." Id. at 149. This is so, said the Court, because the assessment of state taxes on the logging activity would reduce tribal revenues and diminish the profitability of potential contractors. For this reason, *to the extent that the state taxes interfered with the federal objectives regarding Indian timber,* the Court concluded that Congress intended to preempt state taxing authority.

Here, the income tax in question does not interfere with any of the federal objectives expressed in Bracker. The tax is on a non-Indian taxpayer's income: it is not a tax on the

activity of logging. Also, the tax burden falls solely upon the non-Indian taxpayer's income: it does not burden the Indian tribe or its members. Consequently, the tax does not reduce revenues from logging activities to the Indians nor the potential profits to contractors.

Second, since the logging operation in Bracker was performed exclusively on the reservation, the U.S. Supreme Court was equally concerned that the state was "unable to identify any regulatory function or services performed by the state that would justify the assessment of taxes for activities on Bureau and tribal roads within the reservation." In contrast, the taxpayers here are non-Indian residents of Arizona, not a business operating exclusively on the reservation. And unlike the tax in Bracker this tax provides for essential services and programs which are intended to benefit all citizens of the state, including these taxpayers. See New York ex ref. Cohn v. Graves, 300 U.S. 308, 312-3(1937).

In conclusion, the facts here are distinguishable from the facts in Bracker. Moreover, the same concerns that persuaded the Court to hold that the taxes in Bracker were preempted are not present here.

The Department cites Kahn as controlling, and I believe it is. In Kahn, a non- Indian lawyer, who lived on the reservation and worked for the Navajo Nation, claimed that federal law preempted the State's ability to impose a state income tax. 16 Ariz. App. at 18. The trial court granted the state tax commission's motion to dismiss for failure to state a claim upon which relief may be granted. On review, the Court of Appeals rejected taxpayer's argument. Citing McClanahan v. State Tax Commission, the court reasoned that

> ". . .Navajo Indians living and working within the confines of the Navajo Reservation of Arizona are subject to the Arizona State

> Individual Income Tax. And if Navajo Indians are subject to the State Income Tax, then a *fortiori* appellants in the case at bench, as non-Indians are subject to the tax."

Here, the taxpayers are non-Indians who live off the reservation. Taken together with the other authorities cited by the Department, it is clear that a non-Indian who lives off-reservation is subject to Arizona's income tax.

B. Taxing The Income Of Taxpayers Does Not Offend The Historical Traditions of Tribal Sovereignty.

A tax that infringes on the right of tribal self-government is inapplicable to activity undertaken on the reservation or by tribal members. See Oklahoma Tax Comm'n v. Sac and Fox Nation, 508 U.S., 114, 113 S.Ct. 1985 (1993); White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 100 S.Ct. 2578 (1980); McClanahan v. Arizona Tax Comm'n, 411 U.S. 164, 93 S.Ct. 1257 (1973). The most important factor is whether the taxpayer is Indian. Next in importance is the residence of the Indian. If the Indian lives on Indian land, there is a presumption against state taxing authority. See Sac and Fox, 508 U.S. 120. In the case of non-Indians engaging in activity on the reservation,

> [the] inquiry is not dependent on mechanical or absolute conceptions of state or tribal sovereignty, but has called for particularized inquiry into the nature of the state, federal, and tribal interests at stake, an inquiry designed to determine whether in the specific contest, the exercise of state authority would violate federal law.

Bracker, 448 U.S. at 144-45.[1]

Here, the taxpayers are non-Indians who live off, but work on, the reservation. The tax being imposed is an income tax. Taxpayers have not made, nor can I think of any persuasive arguments why the State of Arizona may not tax the income of its own citizens. Nor have taxpayers been able to explain how Arizona, by taxing the income of its own citizens, encroaches on the sovereignty of the Indian Tribes. As the cases cited above make clear, the tax in question does not offend historical notions of tribal sovereignty.

C. Gain From The Sale Of Equipment For Arizona Tax Purposes Is The Same As The Gain Shown On Taxpayers' Federal Return

According to the taxpayers, even if the income derived from the Indian logging operation is not immune from state income tax, no tax is owed because taxpayers did not deduct for depreciation on their Arizona returns. However, for Arizona income tax purposes, the "Arizona gross income" is the same as the federal adjusted income computed pursuant to the Internal Revenue Code. A.R.S. § 43-1001(2) and (4). The taxpayers did not use the federal adjusted income when computing their Arizona returns for 1987 and 1988, but instead subtracted out from their Arizona gross income all of the income derived from the Pinetop Logging Company operations. Nowhere is such a deduction allowed. See A.R.S. § 43-1001(1). Moreover, the taxpayers did take a depreciation deduction of $406,491.00 in 1987 and $400,000.00 on their 1988 federal returns. Therefore, their

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[1] It is not clear whether this "test" is to be used to determine whether tribal sovereignty is violated or whether state taxing authority has been preempted. In any case, I think the income tax in question satisfies the test.

federal adjusted income accounted for any depreciation deductions.

Since the income derived from the logging operation is not immured from state taxation, the taxpayers must file amended state returns using the statutory calculation for Arizona gross income. In so doing, they will get the benefit of the same depreciation deductions they took on their federal returns.

IT IS ORDERED granting the State's motion and denying the taxpayers' motion.

APPENDIX E

BEFORE THE STATE BOARD OF TAX APPEALS,
DIVISION TWO
STATE OF ARIZONA
1501 West Washington, Ste. 224
Phoenix, Arizona 85007
(602) 542-3288

GARY and ELIZABETH LOVENESS, Appellants, vs. ARIZONA DEPARTMENT OF REVENUE, Appellee.	[Filed: November 2, 1994] Docket No. 1045-93-I **NOTICE OF DECISION: FINDINGS OF FACT AND CONCLUSIONS OF LAW**

The State Board of Tax Appeals, Division Two, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follows:

FINDINGS OF FACT

Gary and Elizabeth Loveness ("Appellants") are the sole shareholders of Basin Building Materials Company, Inc. ("Basin"), an Arizona corporation. From October 1968 through 1988 Basin, under the name of Pinetop Logging Co., was engaged in the business of logging and transporting timber and related timber operations on the Fort Apache Indian Reservation under contract with the White Mountain Apache Tribe.

Effective December 1, 1986, Appellants elected to convert Basin into a Subchapter S Corporation. A Subchapter S Corporation must generally file tax returns on a calendar year, so Basin filed a short, year return for the month ending December 31, 1986, and full-year returns for 1987 and 1988. The income of a Subchapter S Corporation is not taxed to the corporation, but instead is shown on the return of the individual shareholder. Therefore, for 1986, 1987 and 1988, Appellants , were required to show the income or losses from Basin on their individual returns.

On their 1987 and 1988 Arizona income tax returns, Appellants subtracted income items related to the Subchapter S Corporation stating the income was "immune from Arizona income by virtue of pre-emptive Federal regulations of harvest of Indian timber." Appellants also claimed a deduction for dividends received from an Arizona corporation under A.R.S. § 43-1052.

The Arizona Department of Revenue ("Department") audited Appellants' 1987 and 1988 returns. The Department disallowed the subtraction of items related to the Subchapter S Corporation as well as the deduction of dividends, and issued an assessment for underpayment of taxes, including interest, late payment and negligence penalties.

After unsuccessfully protesting the assessment before the Department, Appellants now timely appeal to the Board.

DISCUSSION

At the hearing before this Board, the Department waived the late payment and negligence penalties and conceded the dividend issue. Therefore, the only issue remaining is whether Appellants' income share from Basin is subject to State taxation.

There are very few hard and fast rules in the complex area of state taxation on Indian reservations. However, courts

have generally focused on 1) whether a sufficient state interest supports the imposition of a tax, despite heavy federal regulation of the activity; and 2) whether the economic incidence of the tax falls on the tribe, a tribal entity or tribal enterprise. Peabody Coal Co. v. State, 158 Ariz. 190, 196, 761 P.2d 1094 (App. 1988).

Appellants argue that Arizona taxation of the income at issue is preempted by the comprehensive federal regulation of the harvesting of reservation timber. In fact, Appellants maintain that this very issue, involving the very same activities and the very same persons, was thoroughly litigated and conclusively resolved in White Mountain Apache Tribe v. Bracker, 448 U.S. 136 (1980).

In Bracker, the issue was whether Arizona could impose its motor carrier license and use fuel taxes on the use of roads located solely within an Indian reservation by nonmember logging companies. One of the companies was Basin. The State neither built, maintained nor policed the reservation roads and the Court found that the State was "unable to identify any regulatory function or service [it] performed . . . that would justify the assessment of taxes for activities on Bureau and tribal roads within the reservation." 100 S.Ct. at 2586. Further, it was undisputed that the economic burden of the taxes ultimately fell on the Tribe. Id. at 2587-8. Therefore, the Court found the taxes were preempted. Id. at 2586.

The present case involves an income tax on non-Indian Arizona residents who reside off the reservation. There is no case which has held such income to be nontaxable. See Kahn v. State Tax Comm'n, 16 Ariz. App. 17, 490-P.2d 846 (1971), appeal dismissed, 411 U.S. 941 (1973) (rejecting claim of non-Indian lawyer working for and residing on the reservation of the Navajo Nation that his income was nontaxable) (U.S. Supreme Court dismissed for lack of a substantial federal question.) However, Appellants

argue that Basin's income is tax exempt and remains so in the hands of Appellants.

Section 1366.B of the Internal Revenue Code (I.R.C.) provides in part:

> The character of any item included in a shareholder's pro rata share . . . shall be determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation.

Arizona's Subchapter S statute does not contain a similar provision addressing the character of income "passed through" to shareholders. However, Arizona's income tax statutes use federal taxable income as the basis for Arizona income. A.R.S. § 43-308. Therefore, Appellants argue I.R.C. § 1366. B supports the tax exempt status of the income at issue. The Board disagrees.

Appellants improperly characterize income from on-reservation Preemption is a means or determining jurisdiction and has the effect of removing a reservation our of the jurisdiction of the state for some purposes. It does not give on reservation activities some inherent exemption.

In Bracker, in the face of heavy federal regulation of the harvesting of reservation timber, the State could not identify a service use or function it performed to justify imposing tax on the reservation roads which were built, maintained and policed by the logging companies, the Tribe and the Federal Government to facilitate timber harvesting. Further, the adverse economic impact of the tax on the Tribe was undisputed. Therefore, Arizona was preempted from imposing state tax on the logging companies.

In the present case, the State's interest is clear. Appellants enjoy all the rights, privileges and protections of Arizona residents, and the State has jurisdiction to tax their

income from whatever source. A.R.S § 43-102.A.4. Further, the potential economic impact that the tax on Appellants' income may have to the Tribe would be no greater than that caused by the income tax on wages paid to Appellants by the Tribe tax to which Appellants' have never objected. For the foregoing reasons, the Board concludes that Appellants' income is subject to Arizona income tax.

CONCLUSIONS OF LAW

Appellants' income is subject to Arizona income tax. A.R.S § 43102.A.4; see also Peabody Coal Co. v. State, 158 Ariz. 190, 196, 761 P.2d 1094 (App. 1988); Kahn v. State Tax Comm'n, 16 Ariz. App. 17, 490 P.2d 846 (1971), anneal dismissed, 411 U.S. 941 (1973).

ORDER

THEREFORE, IT IS HEREBY ORDERED that the appeal is denied and the final order of the Department is affirmed.

This decision becomes final upon the expiration of thirty (30) days from receipt, unless either the State or the taxpayer brings an action in Superior Court as provided in A.R.S § 42-124.

DATED this 2nd day of November, 1994.

STATE BOARD OF TAX APPEALS

Stephen P. Linzer, Chairman
Division Two

APPENDIX F

STATUTES INVOLVED

(FORMER) ARIZONA REVISED STATUTES § 43-1011 (in effect in 1987 and 1988): Taxes and tax rates.

A. There shall be levied, collected and paid for each taxable year upon the entire taxable income of every resident of this state and upon the entire taxable income of every nonresident which is derived from sources within this state, taxes in the following amounts and at the following rates upon taxable income:

1. On the first one thousand dollars or any part thereof, two per cent.

2. On the second one thousand dollars or any part thereof, three per cent.

3. On the third one thousand dollars or any part thereof, four per cent.

4. On the fourth one thousand dollars or any part thereof, four per cent.

5. On the fifth one thousand dollars or any part thereof, six per cent.

6. One the sixth one thousand dollars or any part thereof, seven per cent.

7. On the seventh one thousand dollars or any part thereof and all taxable income in excess of seven thousand dollars, eight per cent.

B. In the case of a joint return of a husband and wife filed pursuant to § 43-309, the tax imposed by this section shall be twice the tax that would be determined by subsection A of this section if the taxable income of the husband and wife were reduced by one-half.

C. The department shall annually revise the income dollar amounts for each rate bracket prescribed by subsection A of this section to reflect changes mandated by § 43-253.

25 U.S.C.A. § 196: Sale or other disposition of dead timber

The President of the United States may from year to year in his discretion under such regulations as he may prescribe authorize the Indians residing on reservations or allotments, the fee to which remains in the United States, to fell, cut, remove, sell or otherwise dispose of the dead timber standing, or fallen, on such reservation or allotment for the sole benefit of such Indian or Indians. But whenever there is reasonable cause to believe that such timber has been killed, burned, girdled, or otherwise injured for the purpose of securing its sale under this section then in that case such authority shall not be granted.

25 U.S.C.A. § 406: Sale of timber on lands held under trust

(a) Deductions for administrative expenses; standards guiding sales

The timber on any Indian land held under a trust or other patent containing restrictions on alienations may be sold by the owner or owners with the consent of the Secretary of the Interior, and the proceeds from such sales, after deductions for administrative expenses to the extent permissible under section 413 of this title, shall be paid to the owner or owners or disposed of for their benefit under regulations to be prescribed by the Secretary of the Interior. It is the intention of Congress that a deduction for

administrative expenses may be made in any case unless the deduction would violate a treaty obligation or amount to a taking of private property for public use without just compensation in violation of the fifth amendment to the Constitution. Sales of timber under this subsection shall be based upon a consideration of the needs and best interests of the Indian owner and his heirs. The Secretary shall take into consideration, among other things, (1) the state of growth of the timber and the need for maintaining the productive capacity of the land for the benefit of the owner and his heirs, (2) the highest and best use of the land, including the advisability and practicality of devoting it to other uses for the benefit of the owner and his heirs, and (3) the present and future financial needs of the owner and his heirs.

(b) Undivided interests

Upon the request of the owners of a majority Indian interest in land in which any undivided interest is held under a trust or other patent containing restrictions on alienations, the Secretary of the Interior is authorized to sell all undivided Indian trust or restricted interests in any part of the timber on such land.

(c) Unrestricted interests

Upon the request of the owner of an undivided but unrestricted interest in land in which there are trust or restricted Indian interests, the Secretary of the Interior is authorized to include such unrestricted interest in a sale of the trust or restricted Indian interests in timber sold pursuant to this section, and to perform any functions required of him by the contract of sale for both the restricted and the unrestricted interests, including the collection and disbursement of payments for timber and the deduction from such payments of sums in lieu of administrative expenses.

(d) Representation of minors and others

For the purposes of this Act, the Secretary of the Interior is authorized to represent any Indian owner (1) who is a minor, (2) who has been adjudicated non compos mentis, (3) whose ownership interest in a decedent's estate has not been determined, or (4) who cannot be located by the Secretary after a reasonable and diligent search and the giving of notice by publication.

(e) Emergency sales

The timber on any Indian land held under a trust or other patent containing restrictions on alienations may be sold by the Secretary of the Interior without the consent of the owners when in his judgment such action is necessary to prevent loss of values resulting from fire, insects, disease, windthrow, or other natural catastrophes.

(f) Change in status without affecting contractual obligations

A change from a trust or restricted status to an unrestricted status of any interest in timber that has been sold pursuant to this section shall not affect the obligations of the Secretary of the Interior under any contract of sale that is in effect at the time such change in status occurs.

25 U.S.C.A. § 407: Sale of timber on unallotted lands

Under regulations prescribed by the Secretary of the Interior, the timber on unallotted trust land in Indian reservations or on other land held in trust for tribes may be sold in accordance with the principles of sustained-yield management or to convert the land to a more desirable use. After deduction, if any, for administrative expenses under section 413 of this title, the proceeds of the sale shall be used-- (1) as determined by the governing bodies of the tribes concerned and approved by the Secretary, or

(2) in the absence of such a governing body, as determined by the Secretary for the tribe concerned.

APPENDIX G

REGULATIONS INVOLVED

25 C.F.R. Part 163

25 C.F.R. § 163.1: Definitions.

Advance deposits means, in Timber Contract for the Sale of Estimated Volumes, contract-required deposits in advance of cutting which the purchaser furnishes to maintain an operating balance against which the value of timber to be cut will be charged. Advance payments means, in Timber Contract for the Sale of Estimated Volumes, non-refundable partial payments of the estimated value of the timber to be cut. Payments are furnished within 30 days of contract approval and prior to cutting. Advance payments are normally 25 percent of the estimated value of the forest products on each allotment. Advance payments may be required for tribal land.

Alaska Native means native as defined in section 3(b) of the Alaska Native Claims Settlement Act of December 18, 1971 (43 U.S.C. 1604).

ANCSA corporation means both profit and non-profit corporations established pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1604).

Approval means authorization by the Secretary, Area Director, Superintendent, tribe or individual Indian in accordance with appropriate delegations of authority.

Approving officer means the officer approving instruments of sale for forest products or his/her authorized representative.

Authorized representative means an individual or entity duly empowered to make decisions under a direct, clear, and specific delegation of authority.

Authorized tribal representative means an individual or entity duly empowered to make decisions under a direct, clear, and specific delegation of authority from an Indian tribe.

Beneficial owner means an individual or entity who holds an ownership interest in Indian land.

Bid deposit means, in Timber Contract for the Sale of Estimated Volumes or in Timber Contract for the Sale of Predetermined Volumes, a deposit with bid furnished by prospective purchasers. At contract execution, the bid deposit of the successful bidder becomes a portion of the contract required advance deposit in estimated volume contracts or an installment payment in predetermined volume contracts.

Commercial forest land means forest land that is producing or capable of producing crops of marketable forest products and is administratively available for intensive management and sustained production.

Expenditure plan means a written agreement between an Indian tribe and the Secretary documenting tribal commitment to undertake specified forest land management activities within general time frames.

Forest or forest land means an ecosystem at least one acre in size, including timberland and woodland, which: Is characterized by a more or less dense and extensive tree cover; contains, or once contained, at least ten percent tree crown cover, and is not developed or planned for exclusive non-forest resource use.

Forest land management activities means all activities performed in the management of Indian forest land including:

(a) All aspects of program administration and executive direction such as:

(1) Development and maintenance of policy and operational procedures, program oversight, and evaluation;

(2) Securing of legal assistance and handling of legal matters;

(3) Budget, finance, and personnel management; and

(4) Development and maintenance of necessary data bases and program reports.

(b) All aspects of the development, preparation and revision of forest inventory and management plans, including aerial photography, mapping, field management inventories and re-inventories, inventory analysis, growth studies, allowable annual cut calculations, environmental assessment, and forest history, consistent with and reflective of tribal integrated resource management plans where such plans exist.

(c) Forest land development, including forestation, thinning, tree improvement activities, and the use of silvicultural treatments to restore or increase growth and yield to the full productive capacity of the forest environment.

(d) Protection against losses from wildfire, including acquisition and maintenance of fire fighting equipment and fire detection systems, construction

of fire breaks, hazard reduction, prescribed burning, and the development of cooperative wildfire management agreements.

(e) Protection against insects and disease, including:

(1) All aspects of detection and evaluation;

(2) Preparation of project proposals containing project descriptions, environmental assessments and statements, and cost-benefit analyses necessary to secure funding;

(3) Field suppression operations and reporting.

(f) Assessment of damage caused by forest trespass, infestation or fire, including field examination and survey, damage appraisal, investigation assistance and report, demand letter, and testimony preparation.

(g) All aspects of the preparation, administration, and supervision of timber sale contracts, paid and free use permits, and other Indian forest product harvest sale documents, including;

(1) Cruising, product marketing, silvicultural prescription, appraisal and harvest supervision;

(2) Forest product marketing assistance, including evaluation of marketing and development opportunities related to Indian forest products and consultation and advice to tribes, tribal and Indian enterprises on maximization of return on forest products;

(3) Archeological, historical, environmental and other land management reviews, clearances, and analyses;

(4) Advertising, executing, and supervising contracts;

(5) Marking and scaling of timber; and

(6) Collecting, recording and distributing receipts from sales.

(h) Provision of financial assistance for the education of Indians and Alaska Natives enrolled in accredited programs of postsecondary and postgraduate forestry and forestry-related fields of study, including the provision of scholarships, internships, relocation assistance, and other forms of assistance to cover educational expenses.

(i) Participation in the development and implementation of tribal integrated resource management plans, including activities to coordinate current and future multiple uses of Indian forest lands.

(j) Improvement and maintenance of extended season primary and secondary Indian forest land road systems.

(k) Research activities to improve the basis for determining appropriate management measures to apply to Indian forest land.

Forest management deduction means a percentage of the gross proceeds from the sales of forest products harvested from Indian land which is collected by the Secretary pursuant to 25 U.S.C. 413 to cover in whole or in part the cost of managing and protecting such Indian forest lands.

Forest management plan means the principal document, approved by the Secretary, reflecting and consistent with an integrated resource management plan, which provides for the regulation of the detailed, multiple-use operation of Indian forest land by methods ensuring that such lands remain in a continuously productive state while meeting the objectives of the tribe and which shall include: Standards setting forth the funding and staffing requirements necessary to carry out each management plan, with a report of current forestry funding and staffing levels; and standards providing quantitative criteria to evaluate performance against the objectives set forth in the plan.

Forest products means marketable products extracted from Indian forests, such as: Timber; timber products, including lumber, lath, crating, ties, bolts, logs, pulpwood, fuelwood, posts, poles, and split products; bark; Christmas trees, stays, branches, firewood, berries, mosses, pinyon nuts, roots, acorns, syrups, wild rice, mushrooms, and herbs; other marketable material; and gravel which is extracted from, and utilized on, Indian forest land.

Forestry-related field or forestry-related curriculum means a renewable natural resource management field necessary to manage Indian forest land and other professionally recognized fields as approved by the education committee established pursuant to § 163.40(a)(1).

Forest resources means all the benefits derived from Indian forest land, including forest products, soil productivity, water, fisheries, wildlife, recreation, and aesthetic or other traditional values of Indian forest land.

Forester intern means an Indian or Alaska Native who: Is employed as a forestry or forestry-related technician with the Bureau of Indian Affairs, an Indian tribe, or tribal forest-related enterprise; is acquiring necessary academic qualifications to become a forester or a professional trained

in forestry-related fields; and is appointed to one of the Forester Intern positions established pursuant to § 163.40(b).

Indian means a member of an Indian tribe.

Indian enterprise means an enterprise which is designated as such by the Secretary or tribe.

Indian forest land means Indian land, including commercial, non-commercial, productive and non-productive timberland and woodland, that are considered chiefly valuable for the production of forest products or to maintain watershed or other land values enhanced by a forest cover, regardless of whether a formal inspection and land classification action has been taken.

Indian land means land title which is held by: The United States in trust for an Indian, an individual of Indian or Alaska Native ancestry who is not a member of a federally-recognized Indian tribe, or an Indian tribe; or by an Indian, an individual of Indian or Alaska Native ancestry who is not a member of a federally recognized tribe, or an Indian tribe subject to a restriction by the United States against alienation.

Indian tribe or tribe means any Indian tribe, band, nation, rancheria, Pueblo or other organized group or community which is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians and shall mean, where appropriate, the recognized tribal government of such tribe's reservation.

Installment payments means, in Timber Contract for the Sale of Predetermined Volumes, scheduled partial payments of the total contract value based on purchaser bid. Payments made are normally not refundable.

Integrated resource management plan means a document, approved by an Indian tribe and the Secretary,

which provides coordination for the comprehensive management of the natural resources of such tribe's reservation.

Noncommercial forest land means forest land that is available for extensive management, but is incapable of producing sustainable forest products within the general rotation period. Such land may be economically harvested, but the site quality does not warrant significant investment to enhance future crops.

Productive forest land means forest land producing or capable of producing marketable forest products that is unavailable for harvest because of administrative restrictions or because access is not practical.

Reservation means an Indian reservation established pursuant to treaties, Acts of Congress, or Executive Orders and public domain Indian allotments, Alaska Native allotments, rancherias, and former Indian reservations in Oklahoma.

Secretary means the Secretary of the Interior or his or her authorized representative.

Stumpage rate means the stumpage value per unit of measure for a forest product.

Stumpage value means the value of a forest product prior to extraction from Indian forest land.

Sustained yield means the yield of forest products that a forest can produce continuously at a given intensity of management.

Timberland means forest land stocked, or capable of being stocked, with tree species that are regionally utilized for lumber, pulpwood, poles or veneer products.

Trespass means the removal of forest products from, or damaging forest products on, Indian forest land, except when authorized by law and applicable federal or tribal regulations. Trespass can include any damage to forest resources on Indian forest land resulting from activities under contracts or permits or from fire.

Tribal forest enterprise means an Indian enterprise that is initiated and organized by a reservation's recognized tribal government.

Unproductive forest land means forest land that is not producing or capable of producing marketable forest products and is also unavailable for harvest because of administrative restrictions or because access is not practical.

Woodland means forest land not included within the timberland classification, stocked, or capable of being stocked, with tree species of such form and size to produce forest products that are generally marketable within the region for products other than lumber, pulpwood, or veneer.

25 C.F.R. § 163.2: Information collection.

The information collection requirements contained in 25 CFR part 163 do not require the approval of the Office of Management and Budget under 44 U.S.C. 3504(h) et seq.

25 C.F.R. § 163.3: Scope and objectives.

(a) The regulations in this part are applicable to all Indian forest land except as this part may be superseded by legislation.

(b) Indian forest land management activities undertaken by the Secretary shall be designed to achieve the following objectives:

(1) The development, maintenance and enhancement of Indian forest land in a perpetually productive state in accordance with the principles of sustained yield and with the standards and objectives set forth in forest management plans by providing effective management and protection through the application of sound silvicultural and economic principles to the harvesting of forest products, forestation, timber stand improvement and other forestry practices;

(2) The regulation of Indian forest land through the development and implementation, with the full and active consultation and participation of the appropriate Indian tribe, of forest management plans which are supported by written tribal objectives;

(3) The regulation of Indian forest land in a manner that will ensure the use of good method and order in harvesting so as to make possible, on a sustained yield basis, continuous productivity and a perpetual forest business;

(4) The development of Indian forest land and associated value-added industries by Indians and Indian tribes to promote self-sustaining communities, so that Indians may receive from their Indian forest land not only stumpage value, but also the benefit of all the labor and profit that such Indian forest land is capable of yielding;

(5) The retention of Indian forest land in its natural state when an Indian tribe determines that the recreational, cultural, aesthetic, or traditional values of the Indian forest land represents the highest and best use of the land;

(6) The management and protection of forest resources to retain the beneficial effects to Indian forest land of regulating water run-off and minimizing soil erosion; and

(7) The maintenance and improvement of timber productivity, grazing, wildlife, fisheries, recreation, aesthetic, cultural and other traditional values.

25 C.F.R. § 163.4: Secretarial recognition of tribal laws.

Subject to the Secretary's trust responsibilities, and unless otherwise prohibited by Federal statutory law, the Secretary shall comply with tribal laws pertaining to Indian forest land, including laws regulating the environment or historic or cultural preservation, and shall cooperate with the enforcement of such laws on Indian forest land. Such cooperation does not constitute a waiver of United States sovereign immunity and shall include:

(a) Assistance in the enforcement of such laws;

(b) Provision of notice of such laws to persons or entities undertaking activities on Indian forest land; and

(c) Upon the request of an Indian tribe, the appearance in tribal forums.

25 C.F.R. § 163.10: Management of Indian forest land.

(a) The Secretary shall undertake forest land management activities on Indian forest land, either directly or through contracts, cooperative agreements, or grants under the Indian Self-Determination and Education Assistance Act (Pub.L. 93-638, as amended).

(b) Indian forest land management activities undertaken by the Secretary shall be designed to achieve objectives enumerated in § 163.3 of this part.

25 C.F.R. § 163.11: Forest management planning and sustained yield management.

(a) To further the objectives identified in § 163.3 of this part, an appropriate forest management plan shall be prepared and revised as needed for all Indian forest lands. Such documents shall contain a statement describing the manner in which the policies of the tribe and the Secretary will be applied, with a definite plan of silvicultural management, analysis of the short term and long term effects of the plan, and a program of action, including a harvest schedule, for a specified period in the future. Forest management plans shall be based on the principle of sustained yield management and objectives established by the tribe and will require approval of the Secretary.

(b) Forest management planning for Indian forest land shall be carried out through participation in the development and implementation of integrated resource management plans which provide coordination for the comprehensive management of all natural resources on Indian land. If the integrated resource management planning process has not been initiated, or is not ongoing or completed, a stand-alone forest management plan will be prepared.

(c) The harvest of forest products from Indian forest land will be accomplished under the principles of sustained yield management and will not be authorized until practical methods of harvest based on sound economic and silvicultural and other forest management principles have been prescribed. Harvest schedules will be prepared for a specified period of time and updated annually. Such schedules shall support the objectives of the beneficial land owners and the Secretary and shall be directed toward achieving an approximate balance between net growth and harvest at the earliest practical time.

25 C.F.R. § 163.12: Harvesting restrictions.

(a) Harvesting timber on commercial forest land will not be permitted unless provisions for natural and/or artificial reforestation of acceptable tree species is included in harvest plans.

(b) Clearing of large contiguous areas will be permitted only on land that, when cleared, will be devoted to a more beneficial use than growing timber crops. This restriction shall not prohibit clearcutting when it is silviculturally appropriate, based on ecological principles, to harvest a particular stand of timber by such method and it otherwise conforms with objectives in § 163.3 of this part.

25 C.F.R. § 163.13: Indian tribal forest enterprise operations.

Indian tribal forest enterprises may be initiated and organized with consent of the authorized tribal representatives. Such enterprises may contract for the purchase of non-Indian owned forest products. Subject to approval by the Secretary the following actions may be taken:

(a) Authorized tribal enterprises may enter into formal agreements with tribal representatives for the use of tribal forest products, and with individual beneficial Indian owners for their forest products;

(b) Authorized officials of tribal enterprises, operating under approved agreements for the use of Indian-owned forest products pursuant to this section, may sell the forest products produced according to generally accepted trade practices;

(c) With the consent of the beneficial Indian owners, such enterprises may, without advertisement, contract for the purchase of forest products on Indian land at stumpage rates authorized by the Secretary;

(d) Determination of and payment for stumpage and/or products utilized by such enterprises will be authorized in accordance with § 163.22. However, the Secretary may issue special instructions for payment by methods other than those in § 163.22 of this part; and

(e) Performance bonds may or may not be required in connection with operations on Indian land by such enterprises as determined by the Secretary.

25 C.F.R. § 163.14: Sale of forest products.

(a) Consistent with the economic objectives of the tribe and with the consent of the Secretary and authorized by tribal resolution or resolution of recognized tribal government, open market sales of Indian forest products may be authorized. Such sales require consent of the authorized representatives of the tribe for the sale of tribal forest products, and the owners of a majority Indian interest on individually owned lands. Open market sales of forest products from Indian land located off reservations will be permitted with the consent of the Secretary and majority Indian interest of the beneficial Indian owner(s).

(b) On individually owned Indian forest land not formally designated for retention in its natural state, the Secretary may, after consultation, sell the forest products without the consent of the owner(s) when in his or her judgment such action is necessary to prevent loss of value resulting from fire, insects, diseases, windthrow or other catastrophes.

(c) Unless otherwise authorized by the Secretary, each sale of forest products having an estimated stumpage value exceeding $15,000 will not be approved until:

(1) An examination of the forest products to be sold has been made by a forest officer; and

(2) A report setting forth all pertinent information has been submitted to the approving officer as provided in § 163.20 of this part.

(d) With the approval of the Secretary, authorized beneficial Indian owners who have been duly apprised as to the value of the forest products to be sold, may sell or transfer forest products for less than the appraised value.

(e) Except as provided in § 163.14(d) of this part, in all such sales, the forest products shall be appraised and sold at stumpage rates not less than those established by the Secretary.

25 C.F.R. § 163.15: Advertisement of sales.

Except as provided in §§ 163.13, 163.14, 163.16, and 163.26 of this part, sales of forest products shall be made only after advertising.

(a) The advertisement shall be approved by the officer who will approve the instrument of sale. Advertised sales shall be made under sealed bids, or at public auction, or under a combination thereof. The advertisement may limit sales of Indian forest products to Indian forest enterprises, members of the tribe, or may grant to Indian forest enterprises and/or members of the tribe who submitted bids the right to meet the higher bid of a non-member. If the estimated stumpage value of the forest products offered does not exceed $15,000, the advertisement may be made by

posters and circular letters. If the estimated stumpage value exceeds $15,000, the advertisement shall also be made in at least one edition of a newspaper of general circulation in the locality where the forest products are situated. If the estimated stumpage value does not exceed $50,000, the advertisement shall be made for not less than 15 days; if the estimated stumpage value exceeds $50,000 but not $250,000, for not less than 30 days; and if the estimated stumpage value exceeds $250,000, for not less than 60 days.

(b) The approving officer may reduce the advertising period because of emergencies such as fire, insect attack, blowdown, limitation of time, or when there would be no practical advantage in advertising for the prescribed period.

(c) If no instrument of sale is executed after such advertisement, the approving officer may, within one year from the last day on which bids were to be received as defined in the advertisement, permit the sale of such forest products. The sale will be made upon the terms and conditions in the advertisement and at not less than the advertised value or the appraised value at the time of sale, whichever is greater.

25 C.F.R. § 163.16: Forest product sales without advertisement.

(a) Sales of forest products may be made without advertisement to Indians or non-Indians with the consent of the authorized tribal representatives for tribal forest products or with the consent of the beneficial owners of a majority Indian interest of individually owned Indian land, and the approval of the Secretary when:

(1) Forest products are to be cut in conjunction with the granting of a right- of-way;

(2) Granting an authorized occupancy;

(3) Tribal forest products are to be purchased by an Indian tribal forest enterprise;

(4) It is impractical to secure competition by formal advertising procedures;

(5) It must be cut to protect the forest from injury; or

(6) Otherwise specifically authorized by law.

(b) The approving officer shall establish a documented record of each negotiated transaction. This will include:

(1) A written determination and finding that the transaction is a type allowing use of negotiation procedures;

(2) The extent of solicitation and competition, or a statement of the facts upon which a finding of impracticability of securing competition is based; and

(3) A statement of the factors on which the award is based, including a determination as to the reasonability of the price accepted.

25 C.F.R. § 163.17: Deposit with bid.

(a) A deposit shall be made with each proposal for the purchase of Indian forest products. Such deposits shall be at least:

(1) Ten (10) percent if the appraised stumpage value is less than $100,000 and in any event not less than $1,000 or full value whichever is less;

(2) Five (5) percent if the appraised stumpage value is $100,000 to $250,000 but in any event not less than $10,000; and

(3) Three (3) percent if the appraised stumpage value exceeds $250,000 but in any event not less than $12,500.

(b) Deposits shall be in the form of either a certified check, cashier's check, bank draft, postal money order, or irrevocable letter-of-credit, drawn payable as specified in the advertisement, or in cash.

(c) The deposit of the apparent high bidder, and of others who submit a written request to have their bids considered for acceptance will be retained pending acceptance or rejection of the bids. All other deposits will be returned following the opening and posting of bids.

(d) The deposit of the successful bidder will be forfeited and distributed as damages to the beneficial owners if the bidder does not:

(1) Furnish the performance bond required by § 163.21 of this part within the time stipulated in the advertisement for sale of forest products;

(2) Execute the contract; or

(3) Perform the contract.

(e) Forfeiture of a deposit does not limit or waive any further claims for damages available under applicable law or terms of the contract.

(f) In the event of an administrative appeal under 25 CFR part 2, the Secretary may hold such bid deposits in an escrow account pending resolution of the appeal.

25 C.F.R. § 163.18: Acceptance and rejection of bids.

(a) The high bid received in accordance with any advertisement issued under authority of this part shall be accepted, except that the approving officer, having set forth the reason(s) in writing, shall have the right to reject the high bid if:

(1) The high bidder is considered unqualified to fulfill the contractual requirement of the advertisement; or

(2) There are reasonable grounds to consider it in the interest of the Indians to reject the high bid.

(b) If the high bid is rejected, the approving officer may authorize:

(1) Rejection of all bids; or

(2) Acceptance of the offer of another bidder who, at bid opening, makes written request that their bid and bid deposit be held pending a bid acceptance.

(c) The officer authorized to accept the bid shall have the discretion to waive minor technical defects in advertisements and proposals, such as typographical errors and misplaced entries.

25 C.F.R. § 163.19: Contracts for the sale of forest products.

(a) In sales of forest products with an appraised stumpage value exceeding $15,000, the contract forms approved by the Secretary must be used unless a special form for a particular sale or class of sales is approved by the Secretary.

(b) Unless otherwise directed, the contracts for forest products from individually-owned Indian land will be paid by remittance drawn to the Bureau of Indian Affairs and transmitted to the Superintendent. Upon the request of the tribe, the contracts for tribal forest products may require that the proceeds be paid promptly and directly into a bank depository account designated by such tribe, or by remittance drawn to the Bureau of Indian Affairs and transmitted to the Superintendent.

(c) By mutual agreement of the parties to a contract, contracts may be extended, modified, or assigned subject to approval by the approving officer, and may be terminated by the approving officer upon completion or by mutual agreement.

25 C.F.R. § 163.20: Execution and approval of contracts.

(a) All contracts for the sale of tribal forest products shall be executed by the authorized tribal representative(s). There shall be included with the contract an affidavit executed by the authorized tribal representative(s) setting forth the resolution or other authority of the governing body of the tribe. Contracts must be approved by the Secretary to be valid.

(b) Contracts for the sale of individually owned forest products shall be executed by the beneficial Indian owner(s) or the Secretary acting pursuant to a power of attorney from the beneficial Indian owner(s). Contracts must be approved by the Secretary to be valid.

(1) The Secretary may, after consultation with any legally appointed guardian, execute contracts on behalf of minors and beneficial Indian owners who are non compos mentis.

(2) The Secretary may execute contracts for a decedent's estate where ownership has not been determined or for those persons who cannot be located after a reasonable and diligent search and the giving of notice by publication.

(3) Upon the request of the owner of an undivided but unrestricted interest in land in which there are trust or restricted Indian interests, the Secretary may include such unrestricted interest in a sale of the trust or restricted interests in the timber, pursuant to this part, and perform any functions required of him/her by the contract of sale for both the restricted and the unrestricted interests, including the collection and disbursement of payments for timber and the forest management deductions from such payments.

(4) When consent of only a majority interest has been obtained, the Secretary may execute the sale on behalf of all owners to fulfill responsibilities to the beneficiaries of the trust. In such event, the contract file must contain evidence of the effort to obtain consent of all owners. When an individual cannot be located, the Secretary, after a reasonable and diligent search and the giving of notice by publication, may sign a power of attorney consenting to the sale for particular interests. For Indian forest land containing undivided restricted and unrestricted interests, only the restricted interests are considered in determining if a majority interest has been obtained.

25 C.F.R. § 163.21: Bonds required.

(a) Performance bonds will be required in connection with all sales of forest products, except they may or may not be required, as determined by the approving officer, in connection with the use of forest products by Indian tribal forest enterprises pursuant to this part in § 163.13 or in timber cutting permits issued pursuant to § 163.26 of this part.

(1) In sales in which the estimated stumpage value, calculated at the appraised stumpage rates, does not exceed $15,000, the bond shall be at least 20 percent of the estimated stumpage value.

(2) In sales in which the estimated stumpage value exceeds $15,000 but is not over $150,000, the bond shall be at least 15 percent of the estimated stumpage value but not less than $3,000.

(3) In sales in which the estimated stumpage value exceeds $150,000, but is not over $350,000, the bond shall be at least 10 percent of the estimated stumpage value but not less than $22,500.

(4) In sales in which the estimated stumpage value exceeds $350,000, the bond shall be at least 5 percent of the estimated stumpage value but not less than $35,000.

(b) Bonds shall be in a form acceptable to the approving officer and may include:

(1) A corporate surety bond by an acceptable surety company;

(2) A cash bond designating the approving officer to act as trustee under terms of an appropriate trust;

(3) Negotiable U.S. Government securities supported by an appropriate trust instrument; or

(4) An irrevocable letter of credit.

25 C.F.R. § 163.22: Payment for forest products.

(a) The basis of volume determination for forest products sold shall be the Scribner Decimal C log rules, cubic volume, lineal measurement, piece count, weight, or such

other form of measurement as the Secretary may authorize for use. With the exception of Indian tribal forest enterprises pursuant to § 163.13 of this part, payment for forest products will be required in advance of cutting for timber, or removal for other forest products.

(b) Upon the request of an Indian tribe, the Secretary may provide that the purchaser of the forest products of such tribe, which are harvested under a timber sale contract, permit, or other harvest sale document to make advanced deposits, or direct payments of the gross proceeds of such forest products, less any amounts segregated as forest management deductions pursuant to § 163.25 of this part, into accounts designated by such Indian tribe. Such accounts may be in one or more of the following formats:

(1) Escrow accounts at a tribally designated financial institution for receiving deposits with bids and advance deposits from which direct disbursements for timber harvested shall be made to tribes and forest management deductions accounts; or

(2) Tribal depository accounts for receiving advance payments, installment payments, payments from Indian tribal forest enterprises, and/or disbursements from advance deposit accounts or escrow accounts.

(c) The format must allow the Secretary to maintain trust responsibility through written verification that all required deposits, payments, and disbursements have been made.

(d) Terms and conditions for payment of forest products under lump sum (predetermined volume) sales shall be specified in forest product contract documents.

25 C.F.R. § 163.23: Advance payment for timber products.

(a) Unless otherwise authorized by the Secretary, and except in the case of lump sum (predetermined volume) sales, contracts for the sale of timber from allotted, trust or restricted Indian forest land shall provide for an advance payment of up to 25 percent of the stumpage value, calculated at the bid price, within 30 days from the date of approval and before cutting begins. Additional advance payments may be specified in contracts. However, no advance payment will be required that would make the sum of such payment and of advance deposits and advance payments previously applied against timber cut from each ownership in a sale exceed 50 percent of the bid stumpage value. Advance payments shall be credited against the timber of each ownership in the sale as the timber is cut and scaled at stumpage rates governing at the time of scaling. Advance payments are not refundable.

(b) Advance payments may be required on tribal land. When required, advance payments will operate the same as provided for in § 163.23(a) of this part.

25 C.F.R. § 163.24: Duration of timber contracts.

After the effective date of a forest product contract, unless otherwise authorized by the Secretary, the maximum period which shall be allowed for harvesting the estimated volume of timber purchased, shall be five years.

25 C.F.R. § 163.25: Forest management deductions.

(a) Pursuant to the provisions of 25 U.S.C. 413 and 25 U.S.C. 3105, a forest management deduction shall be withheld from the gross proceeds of sales of forest products harvested from Indian forest land as described in this section.

(b) Gross proceeds shall mean the value in money or money's worth of consideration furnished by the purchaser

of forest products purchased under a contract, permit, or other document for the sale of forest products.

(c) Forest management deductions shall not be withheld where the total Consideration furnished under a contract, permit or other document for the sale of forest products is less than $5,001.

(d) Except as provided in § 163.25(e) of this part, the amount of the forest management deduction shall not exceed the lesser amount of ten percent (10%) of the gross proceeds or, the actual percentage in effect on November 28, 1990.

(e) The Secretary may increase the forest management deduction percentage for Indian forest land upon receipt of a written request from a tribe supported by a resolution executed by the authorized tribal representatives. At the request of the authorized tribal representatives and at the discretion of the Secretary the forest management deduction percentage may be decreased to not less than one percent (1%) or the requirement for collection may be waived.

(f) Forest management deductions are to be utilized to perform forest land management activities in accordance with an approved expenditure plan. Expenditure plans shall describe the forest land management activities anticipated to be undertaken, establish a time period for their completion, summarize anticipated obligations and expenditures, and specify the method through which funds are to be transferred or credited to tribal accounts from special deposit accounts established to hold amounts withheld as forest management deductions. Any forest management deductions that have not been incorporated into an approved expenditure plan by the end of the fiscal year following the fiscal year in which the deductions are withheld, shall be collected into the general funds of the United States Treasury pursuant to 25 U.S.C. 413.

(1) For Indian forest lands located on an Indian reservation, a written expenditure plan for the use of forest management deductions shall be prepared annually and approved by the authorized tribal representative(s) and the Secretary. The approval of the expenditure plan by the authorized tribal representatives constitutes allocation of tribal funds for Indian forest land management activities. Approval of the expenditure plan by the Secretary shall constitute authority for crediting of forest management deductions to tribal account(s). The full amount of any deduction collected by the Secretary plus any income or interest earned thereon shall be available for expenditure according to the approved expenditure plan for the performance of forest land management activities on the reservation from which the forest management deduction is collected.

(2) Forest management deductions shall be handled in the same manner as described under § 163.25(f)(1) of this part if the expenditure plan approved by an Indian tribe and the Secretary provides for the conduct of forest land management activities on Indian forest lands located outside the boundaries of an Indian reservation.

(3) For public domain and Alaska Native allotments held in trust for Indians by the United States, forest management deductions may be utilized to perform forest land management activities on such lands in accordance with an expenditure plan approved by the Secretary.

(g) Forest management deductions withheld pursuant to this section shall not be available to cover the costs that are paid from funds appropriated for fire suppression or pest control or otherwise offset federal appropriations for meeting the Federal trust responsibility for management of Indian forest land.

(h) Within 120 days after the close of the tribal fiscal year, tribes shall submit to the Secretary a written report detailing the actual expenditure of forest management deductions during the past fiscal year. The Secretary shall have the right to inspect accounts, books, or other tribal records supporting the report.

(i) Forest management deductions incorporated into an expenditure plan approved by the Secretary shall remain available until expended.

(j) As provided in § 163.25(f) of this part, only forest management deductions that have not been incorporated into an approved expenditure plan may be deposited to a U.S. Treasury miscellaneous receipt account. No amount collected as forest management deductions shall be credited to any Federal appropriation. No other forest management deductions or fees derived from Indian forest land shall be collected to be covered into the general funds of the United States Treasury.

25 C.F.R. § 163.26: Forest product harvesting permits.

(a) Except as provided in §§ 163.13 and 163.27 of this part, removal of forest products that are not under formal contract, pursuant to § 163.19, shall be under forest product harvesting permit forms approved by the Secretary. Permits will be issued only with the written consent of the beneficial Indian owner(s) or the Secretary, for harvest of forest products from Indian forest land, as authorized in § 163.20 of this part. To be valid, permits must be approved by the Secretary. Minimum stumpage rates at which forest products may be sold will be set at the time consent to issue the permit is obtained. Payment and bonding requirements will be stipulated in the permit document as appropriate.

(b) Free use harvesting permits issued shall specify species and types of forest products to be removed. It may be stipulated that forest products removed under this

authority cannot be sold or exchanged for other goods or services. The estimated value which may be harvested in a fiscal year by any individual under this authority shall not exceed $5,000. For the purpose of issuance of free use permits, individual shall mean an individual Indian or any organized group of Indians.

(c) Paid permits subject to forest management deductions, as provided in § 163.25 of this part, may be issued. Unless otherwise authorized by the Secretary, the stumpage value which may be harvested under paid permits in a fiscal year by any individual under this authority shall not exceed $25,000. For the purpose of issuance of paid permits, individual shall mean an individual or any operating entity comprised of more than one individual.

(d) A Special Allotment Timber Harvest Permit may be issued to an Indian having sole beneficial interest in an allotment to harvest and sell designated forest products from his or her allotment. The special permit shall include provision for payment by the Indian of forest management deductions pursuant to § 163.25 of this part. Unless waived by the Secretary, the permit shall also require the Indian to make a bond deposit with the Secretary as required by § 163.21. Such bonds will be returned to the Indian upon satisfactory completion of the permit or will be used by the Secretary in his or her discretion for planting or other work to offset damage to the land or the timber caused by failure to comply with the provisions of the permit. As a condition to granting a special permit under authority of this paragraph, the Indian shall be required to provide evidence acceptable to the Secretary that he or she has arranged a bona fide sale of the forest products, on terms that will protect the Indian's interests.

25 C.F.R. § 163.27: Free-use harvesting without permits.

With the consent of the beneficial Indian owners and the Secretary, Indians may harvest designated types of forest

products from Indian forest land without a permit or contract, and without charge. Forest products harvested under this authority shall be for the Indian's personal use, and shall not be sold or exchanged for other goods or services.

25 C.F.R. § 163.28: Fire management measures.

(a) The Secretary is authorized to maintain facilities and staff, hire temporary labor, rent fire fighting equipment, purchase tools and supplies, and pay for their transportation as needed, to maintain an adequate level of readiness to meet normal wildfire protection needs and extinguish forest or range fires on Indian land. No expenses for fighting a fire outside Indian lands may be incurred unless the fire threatens Indian land or unless the expenses are incurred pursuant to an approved cooperative agreement with another protection agency. The rates of pay for fire fighters and for equipment rental shall be the rates for fire fighting services that are currently in use by public and private wildfire protection agencies adjacent to Indian reservations on which a fire occurs, unless there are in effect at the time different rates that have been approved by the Secretary. The Secretary may also enter into reciprocal agreements with any fire organization maintaining protection facilities in the vicinity of Indian reservations or other Indian land for mutual aid in wildfire protection. This section does not apply to the rendering of emergency aid, or agreements for mutual aid in fire protection pursuant to the Act of May 27, 1955 (69 Stat. 66).

(b) The Secretary is authorized to conduct a wildfire prevention program to reduce the number of person-caused fires and prevent damage to natural resources on Indian land.

(c) The Secretary is authorized to expend funds for emergency rehabilitation measures needed to stabilize soil and watershed on Indian land damaged by wildfire.

(d) Upon consultation with the beneficial Indian owners, the Secretary may use fire as a management tool on Indian land to achieve land and/or resource management objectives.

25 C.F.R. § 163.29: Trespass.

(a) Trespassers will be liable for civil penalties and damages to the enforcement agency and the beneficial Indian owners, and will be subject to prosecution for acts of trespass.

(1) Cases in Tribal Court. For trespass actions brought in tribal court pursuant to these regulations, the measure of damages, civil penalties, remedies and procedures will be as set forth in this § 163.29 of this part. All other aspects of a tribal trespass prosecution brought under these regulations will be that prescribed by the law of the tribe in whose reservation or within whose jurisdiction the trespass was committed, unless otherwise prescribed under federal law. Absent applicable tribal or federal law, the measure of damages shall be that prescribed by the law of the state in which the trespass was committed.

(2) Cases in Federal Court. For trespass actions brought in Federal court pursuant to these regulations, the measure of damages, civil penalties, remedies and procedures will be as set forth in this § 163.29. In the absence of applicable federal law, the measure shall be that prescribed by the law of the tribe in whose reservation or within whose jurisdiction the trespass was committed, or in the absence of tribal law, the law of the state in which it was committed.

(3) Civil penalties for trespass include, but are not limited to:

(i) Treble damages, whenever any person, without lawful authority injures, severs, or carries off

from a reservation any forest product as defined in § 163.1 of this part. Proof of Indian ownership of the premises and commission of the acts by the trespasser are prima facie evidence sufficient to support liability for treble damages, with no requirement to show willfulness or intent. Treble damages shall be based upon the highest stumpage value obtainable from the raw materials involved in the trespass.

(ii) Payment of costs associated with damage to Indian forest land includes, but is not limited to, rehabilitation, reforestation, lost future revenue and lost profits, loss of productivity, and damage to other forest resources.

(iii) Payment of all reasonable costs associated with the enforcement of these trespass regulations beginning with detection and including all processes through the prosecution and collection of damages, including but not limited to field examination and survey, damage appraisal, investigation assistance and reports, witness expenses, demand letters, court costs, and attorney fees.

(iv) Interest calculated at the statutory rate prescribed by the law of the tribe in whose reservation or within whose jurisdiction the trespass was committed, or in the absence of tribal law in the amount prescribed by federal law. Where tribal law or federal law does not supply a statutory interest rate, the rate of interest shall be statutory rate upon judgments as prescribed by the law of the state in which the trespass was committed. Interest shall be based on treble the highest stumpage value obtainable from the raw materials involved in the trespass, and calculated from the date of the trespass until payment is rendered.

(b) Any cash or other proceeds realized from forfeiture of equipment or other goods or from forest products damaged or taken in the trespass shall be applied to satisfy civil penalties and other damages identified under §

163.29(a) of this part. After disposition of real and personal property to pay civil penalties and damages resulting from trespass, any residual funds shall be returned to the trespasser. In the event that collection and forfeiture actions taken against the trespasser result in less than full recovery, civil penalties shall be distributed as follows:

(1) Collection of damages up to the highest stumpage value of the trespass products shall be distributed pro rata between the Indian beneficial owners and any costs and expenses needed to restore the trespass land; or

(2) Collections exceeding the highest stumpage value of the trespass product, but less than full recovery, shall be proportionally distributed pro rata between the Indian beneficial owners, the law enforcement agency, and the cost to restore the trespass land. Forest management deductions shall not be withheld where less than the highest stumpage value of the unprocessed forest products taken in trespass has been recovered.

(c) Indian beneficial owners who trespass, or who are involved in trespass upon their own land, or undivided land in which such owners have a partial interest, shall not receive their beneficial share of any civil penalties and damages collected in consequence of the trespass. Any civil penalties and damages defaulted in consequence of this provision instead shall be distributed first toward restoration of the land subject of the trespass and second toward costs of the enforcement agency in consequence of the trespass, with any remainder to the forest management deduction account of the reservation in which the trespass took place.

(d) Civil penalties and other damages collected under these regulations, except for penalties and damages provided for in §§ 163.29(a)(3) (ii) and (iii) of this part, shall be treated as proceeds from the sale of forest products from the Indian forest land upon which the trespass occurred.

(e) When a federal official or authorized tribal representative pursuant to § 163.29(j) of this part has reason to believe that Indian forest products are involved in trespass, such individual may seize and take possession of the forest products involved in the trespass if the products are located on reservation. When forest products are seized, the person seizing the products must at the time of the seizure issue a Notice of Seizure to the possessor or claimant of the forest products. The Notice of Seizure shall indicate the date of the seizure, a description of the forest products seized, the estimated value of forest products seized, an indication of whether the forest products are perishable, and the name and authority of the person seizing the forest products. Where the official initiates seizure under these regulations only, the Notice of Seizure shall further include the statement that any challenge or objection to the seizure shall be exclusively through administrative appeal pursuant to part 2 of Title 25, and shall provide the name and the address of the official with whom the appeal may be filed. Alternately, an official may exercise concurrent tribal seizure authority under these regulations using applicable tribal law. In such case, the Notice of Seizure shall identify the tribal law under which the seizure may be challenged, if any. A copy of a Notice of Seizure shall be given to the possessor or claimant at the time of the seizure. If the claimant or possessor is unknown or unavailable, Notice of Seizure shall be posted on the trespass property, and a copy of the Notice shall be kept with any incident report generated by the official seizing the forest products. If the property seized is perishable and will lose substantial value if not sold or otherwise disposed of, the representative of the Secretary, or authorized tribal representative where deferral has been requested, may cause the forest products to be sold. Such sale action shall not be stayed by the filing of an administrative appeal nor by a challenge of the seizure action through a tribal forum. All proceeds from the sale of the forest products shall be placed into an escrow account and held until adjudication or other resolution of the underlying trespass. If it is found that the

forest products seized were involved in a trespass, the proceeds shall be applied to the amount of civil penalties and damages awarded. If it is found that a trespass has not occurred or the proceeds are in excess of the amount of the judgment awarded, the proceeds or excess proceeds shall be returned to the possessor or claimant.

(f) When there is reason to believe that Indian forest products are involved in trespass and that such products have been removed to land not under federal or tribal government supervision, the federal official or authorized tribal representative pursuant to § 163.29(k) of this part responsible for the trespass shall immediately provide the following notice to the owner of the land or the party in possession of the trespass products:

(1) That such products could be Indian trust property involved in a trespass; and

(2) That removal or disposition of the forest products may result in criminal and/or civil action by the United States or tribe.

(g) A representative of the Secretary or authorized tribal representative pursuant to § 163.29(j) of this part will promptly determine if a trespass has occurred. The appropriate representative will issue an official Notice of Trespass to the alleged trespasser and, if necessary, the possessor or potential buyer of any trespass products. The Notice is intended to inform the trespasser, buyer, or the processor:

(1) That a determination has been made that a trespass has occurred;

(2) The basis for the determination;

(3) An assessment of the damages, penalties and costs;

(4) Of the seizure of forest products, if applicable; and

(5) That disposition or removal of Indian forest products taken in the trespass may result in civil and/or criminal action by the United States or the tribe.

(h) The Secretary may accept payment of damages in the settlement of civil trespass cases. In the absence of a court order, the Secretary will determine the procedure and approve acceptance of any settlements negotiated by a tribe exercising its concurrent jurisdiction pursuant to § 163.29(j) of this part.

(i) The Secretary may delegate by written agreement or contract, responsibility for detection and investigation of forest trespass.

(j) Indian tribes that adopt the regulations set forth in this section, conformed as necessary to tribal law, shall have concurrent civil jurisdiction to enforce 25 U.S.C. 3106 and this section against any person.

(1) The Secretary shall acknowledge said concurrent civil jurisdiction over trespass, upon:

(i) Receipt of a formal tribal resolution documenting the tribe's adoption of this section; and

(ii) Notification of the ability of the tribal court system to properly adjudicate forest trespass cases, including a statement that the tribal court will enforce the Indian Civil Rights Act or a tribal civil rights law that contains provisions for due process and equal protection that are similar to or stronger than those contained in the Indian Civil Rights Act.

(2) Where an Indian tribe has acquired concurrent civil jurisdiction over trespass cases as set forth in § 163.29(j)(1) of this part, the Secretary and tribe's authorized representatives will be jointly responsible to coordinate prosecution of trespass actions. The Secretary shall, upon timely request of the tribe, defer prosecution of forest trespasses to the tribe. Where said deferral is not requested, the designated Bureau of Indian Affairs forestry trespass official shall coordinate with the authorized forest trespass official of each tribe the exercise of concurrent tribal and Federal trespass jurisdiction as to each trespass. Such officials shall review each case, determine in which forums to recommend bringing an action, and promptly provide their recommendation to the Federal officials responsible for initiating and prosecuting forest trespass cases. Where an Indian tribe has acquired concurrent civil jurisdiction, but does not request deferral of prosecution, the federal officials responsible for initiating and prosecuting such cases may file and prosecute the action in the tribal court or forum.

(3) The Secretary may rescind an Indian tribe's concurrent civil jurisdiction over trespass cases under this regulation if the Secretary or a court of competent jurisdiction determines that the tribal court has not adhered to the due process or equal protection requirements of the Indian Civil Rights Act. If it is determined that said rescission is justified, the Secretary shall provide written Notice of the rescission, including the findings justifying the rescission and the steps needed to remedy the violations causing the rescission, to the chief judge of the tribal judiciary or other authorized tribal official should there be no chief judge. If said steps are not taken within 60 days, the Secretary's rescission of concurrent civil jurisdiction shall become final. The affected tribe(s) may appeal a Notice of Rescission under part 2 of Title 25.

(4) Nothing shall be construed to prohibit or in any way diminish the authority of a tribe to prosecute

individuals under its criminal or civil trespass laws where it has jurisdiction over those individuals.

25 C.F.R. § 163.30: Revocable road use and construction permits for removal of commercial forest products.

(a) In accordance with 25 U.S.C. 415 as amended, the Secretary may request tribes and/or other beneficial owners to sign revocable permits designating the Secretary as agent for the landowner and empowering him or her to issue revocable road use and construction permits to users for the purpose of removing forest products.

(b) When a majority of trust interest in a tract has consented, the Secretary may issue revocable road use and construction permits for removal of forest products over and across such land. In addition, the Secretary may act for individual owners when:

(1) One or more of the individual owner(s) of the land or of an interest therein is a minor or a person non compos mentis, and the Secretary finds that such grant, in total or for an interest therein, will cause no substantial injury to the land or the owner, which cannot be adequately compensated for by monetary damages;

(2) The whereabouts of the owner(s) of the land or those with an interest therein are unknown so long as the majority of owner(s) of interests whose whereabouts are known, consent to the grant;

(3) The heirs or devisees of a deceased owner of the land or interest have not been determined, and the Secretary finds the grant will cause no substantial injury to the land or any land owner; or

(4) The owners of interests in the land are so numerous that the Secretary finds it would be impractical to obtain the consent of the majority and finds that such grant

in total or an interest therein will cause no substantial injury to the land or the owner(s), that cannot be adequately compensated for by monetary damages.

(c) Nothing in this section shall preclude acquisition of rights-of-way over Indian lands, under 25 CFR part 169, or conflict with provisions of that part.

25 C.F.R. § 163.31: Insect and disease control.

(a) The Secretary is authorized to protect and preserve Indian forest land from disease or insects (Sept. 20, 1922, Ch. 349, 42 Stat. 857). The Secretary shall consult with the authorized tribal representatives and beneficial owners of Indian forest land concerning control actions.

(b) The Secretary is responsible for controlling and mitigating harmful effects of insects and diseases on Indian forest land and will coordinate control actions with the Secretary of Agriculture in accordance with 92 Stat. 365, > 16 U.S.C. 2101.

25 C.F.R. § 163.32: Forest development.

Forest development pertains to forest land management activities undertaken to improve the sustainable productivity of commercial Indian forest land. The program shall consist of reforestation, timber stand improvement projects, and related investments to enhance productivity of commercial forest land with emphasis on accomplishing on-the-ground projects. Forest development funds will be used to re-establish, maintain, and/or improve growth of commercial timber species and control stocking levels on commercial forest land. Forest development activities will be planned and executed using benefit-cost analyses as one of the determinants in establishing priorities for project funding.

25 C.F.R. § 163.33: Administrative appeals.

Any challenge to action under 25 CFR part 163 taken by an approving officer or subordinate official exercising delegated authority from the Secretary shall be exclusively through administrative appeal or as provided in the Indian Self- Determination and Education Assistance Act (Pub.L. 93-638, as amended). Such appeal(s) shall be filed in accordance with the provisions of 25 CFR part 2, Appeals from administrative actions, except that an appeal of any action under part 163 of this title shall:

(a) Not stay any action unless otherwise directed by the Secretary; and

(b) Define "interested party" for purposes of bringing such an appeal or participating in such an appeal as any person whose own direct economic interest is adversely affected by an action or decision.

25 C.F.R. § 163.34: Environmental compliance.

Actions taken by the Secretary under the regulations in this part must comply with the National Environmental Policy Act of 1969, applicable Council on Environmental Quality Regulations, and tribal laws and regulations.

25 C.F.R. § 163.35: Indian forest land assistance account.

(a) At the request of a tribe's authorized representatives, the Secretary may establish tribal-specific forest land assistance accounts within the trust fund system.

(b) Deposits shall be credited either to forest transportation or to general forest land management accounts.

(c) Deposits into the accounts may include:

(1) Funds from non-federal sources related to activities on or for the Indian forest land of such tribe's reservation;

(2) Donations or contributions;

(3) Unobligated forestry appropriations for the tribe;

(4) User fees; and

(5) Funds transferred under Federal interagency agreements if otherwise authorized by law.

(d) For purposes of § 163.35(c)(3) of this part; unobligated forestry appropriations shall consist of balances that remain unobligated at the end of the fiscal year(s) for which funds are appropriated for the benefit of an Indian tribe.

(e) Funds in the Indian forest land assistance account plus any interest or other income earned shall remain available until expended and shall not be available to otherwise offset Federal appropriations for the management of Indian forest land.

(f) Funds in the forest land assistance account shall be used only for forest land management activities on the reservation for which the account is established.

(g) Funds in a tribe's forest land assistance account shall be expended in accordance with a plan approved by the tribe and the Secretary.

(h) The Secretary may, where circumstances warrant, at the request of the tribe, or upon the Secretary's own volition, conduct audits of the forest land assistance accounts and shall provide the audit results of to the tribe(s).

25 C.F.R. § 163.36: Tribal forestry program financial support.

(a) The Secretary shall maintain a program to provide financial support to qualifying tribal forestry programs. A qualifying tribal forestry program is an organization or entity established by a tribe for purposes of carrying out forest land management activities. Such financial support shall be made available through the Indian Self-Determination and Education Assistance Act (Pub.L. 93-638, as amended).

(b) The authorized tribal representatives of any category 1, 2, or 3 reservation (as defined under § 163.36(b)(1)-(3)) with an established tribal forestry program or with an intent to establish such a program for the purpose of carrying out forest land management activities may apply and qualify for tribal forestry program financial support. Reservation categories, as determined by the Secretary, are defined as:

(1) Category 1 includes major forested reservations comprised of more than 10,000 acres of trust or restricted commercial timberland or having more than a one million board foot harvest of forest products annually.

(2) Category 2 includes minor forested reservations comprised of less than 10,000 acres of trust or restricted commercial timberland and having less than a one million board foot harvest of forest products annually, or whose forest resource is determined by the Secretary to be of significant commercial timber value.

(3) Category 3 includes significant woodland reservations comprised of an identifiable trust or restricted forest area of any size which is lacking a timberland component, and whose forest resource is determined by the Secretary to be of significant commercial woodland value.

(c) A group of tribes that has either established or intends to establish a cooperative tribal forestry program to

provide forest land management services to their reservations may apply and qualify for tribal forestry program financial support. For purposes of financial support under this provision, the cooperative tribal forestry program and the commercial forest acreage and annual allowable cut which it represents may be considered as a single reservation.

(d) Before the beginning of each Federal fiscal year, tribes applying to qualify for forestry program financial support shall submit application packages to the Secretary which:

(1) Document that a tribal forestry program exists or that there is an intent to establish such a program;

(2) Describe forest land management activities and the time line for implementing such activities which would result from receiving tribal forestry program financial support; and

(3) Document commitment to sustained yield management.

(e) Tribal forestry program financial support shall provide professional and technical services to carry out forest land management activities and shall be based on levels of funding assistance as follows:

(1) Level one funding assistance shall be equivalent to a Federal Employee General Pay Schedule GS 9 step 5 position salary plus an additional 40 percent of the annual salary for such a position to pay for fringe benefits and support costs;

(2) Level two funding assistance shall be equivalent to an additional Federal Employee General Pay Schedule GS 9 step 5 position salary plus an additional

40 percent of the annual salary for such a position to pay for fringe benefits and support costs; and

(3) Level three funding assistance shall be based on equal distribution of remaining funds among qualifying applicants.

(f) Determination of qualification for level of funding assistance shall be as follows:

(1) A funding level qualification value shall be determined for each eligible applicant using the formula below. Such formula shall only be used to determine which applicants qualify for level one funding assistance. Acreage and allowable cut data used in the formula shall be as maintained by the Secretary. Eligible applicants with a funding level qualification value of one (1) or greater shall qualify for level one assistance.

Funding Level Qualification Formula

[(.5 x CA / Tot. CA) + (.5 x AAC / Tot. AAC)] x 1000
where:
CA=applicant's total commercial Indian forest land acres;
Tot. CA=national total commercial Indian forest land acres;

AAC=applicant's total allowable annual cut from commercial Indian forest land acres; and
Tot. AAC=national total allowable annual cut from commercial Indian forest land acres.

(2) All category 1 or 2 reservations that are eligible applicants under § 163.36(d) of this part are qualified and eligible for level two assistance.

(3) All category 1, 2 or 3 reservations that are eligible applicants under § 163.36(d) of this part are qualified and eligible for level three assistance.

(g) Tribal forestry program financial support funds shall be distributed based on the following:

(1) All requests from reservations qualifying for level one funding assistance must be satisfied before funds are made available for level two funding assistance;

(2) All requests from reservations qualifying for level two funding assistance must be satisfied before funds are made available for level three funding assistance; and

(3) If available funding is not adequate to satisfy all requests at a particular level of funding, funds will be evenly divided among tribes qualifying at that level.

25 C.F.R. § 163.37: Forest management research.

The Secretary, with the consent of the authorized Indian representatives' is authorized to perform forestry research activities to improve the basis for determining appropriate land management activities to apply to Indian forest land.

[25 C.F.R. § 163.40 and § 163.41 omitted]

APPENDIX H

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IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN THE ARIZONA TAX COURT

GARY LOVENESS and ELIZABETH LOVENESS, husband and wife,	)	DOCKET NO. TX 94-00998
Plaintiffs,	)	[Filed: November 16, 1994]
vs.	)	
STATE OF ARIZONA, ex rel. ARIZONA DEPARTMENT OF REVENUE,	)	ACTION PURSUANT TO A.R.S. § 42-124 TO DETERMINE VALIDITY OF PROPOSED INCOME TAX DEFICIENCY ASSESSMENT
Defendant	)	

For their Complaint against defendant, plaintiffs state and allege as follows:

1. Plaintiffs Gary Loveness and Elizabeth Loveness, husband and wife, are residents of the State of Washington. At the times relevant to the assessments at

issue in this Complaint, plaintiffs were residents of the State of Arizona.

2. Defendant Arizona Department of Revenue is a Department of the State of Arizona.

3. Gary and Elizabeth Loveness are the sole shareholders of Basin Building Materials Company, Inc. ("Basin"), an Arizona corporation. At all relevant times, Basin was engaged in the business of logging and transporting timber and related timber operations on the White Mountains Apache Indian Reservation in conjunction with the Apache Tribe and has been so engaged for many years. Basin conducted business under the name of Pinetop Logging Company.

4. In the late 1960's and early 1970's, while the taxpayers were engaged in the same business, conducted by the same corporation, Basin, under the name of Pinetop Logging Company, the State of Arizona sought to impose motor carrier license and use fuel taxes on the business.

5. In the case of White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 100 S.Ct. 2578, 65 L.Ed. 665 (1980), the United States Supreme Court determined that the taxpayers' business activity was not subject to tax by the State of Arizona because federal law and regulations had preempted any such taxing authority. Thereafter, Basin consistently claimed exemption from Arizona state income tax, and the Department of Revenue acquiesced in such exemption.

6. At the end of 1986, the plaintiffs elected to convert Basin into a Subchapter S corporation. Thereafter, in filing their individual Arizona income tax returns, they exempted from income on those returns their allocable share of the income earned by Basin from the timber activities which had been declared exempt from state tax in Bracker. Such exemption was set forth explicitly on each individual

income tax return. The taxpayers reported and paid Arizona income tax on the salaries received by them as officers and employees of Basin.

7. On May 14, 1990, the Department of Revenue proposed a deficiency in the taxpayer's personal income tax returns for the years 1987 and 1988.

8. The adjustment to income proposed by the Department of Revenue for the tax year 1987 was $594,934.00. Of the $594,934.00 in proposed adjustment, $564,903.00 represented the inclusion in Arizona taxable income of the taxpayers' allocable share of Basin's income from the Indian timber operations. An additional $2,136.00 represented an alleged overstatement of federal withholding tax on the 1987 return, and the final $27,895.00 represented a disallowance of a deduction for a dividend from an Arizona corporation. This adjustment resulted in a proposed increase in tax of $47,594.68, negligence penalties and late payment penalties in the combined amount of $9,518.94, together with accruing interest.

9. For the year 1988, the Department of Revenue proposed an adjustment to income in the amount of $1,285,595.00, all of which represented an inclusion in Arizona income of the income of Basin allocable to the taxpayers pursuant to the provisions of Subchapter S. This adjustment resulted in a proposed increase in tax of $64,430.40, claimed penalties for negligence and late payment in the combined amount of $12,886.08, plus accruing interest.

10. The taxpayers timely protested the proposed assessments by protest letter dated June 22, 1990.

11. A formal hearing was held before the Arizona Department of Revenue Appeals Section on September 15, 1992. The Department of Revenue hearing officer entered

his decision on February 25, 1993, upholding the proposed assessment of the Department of Revenue.

12. The decision of the hearing officer was timely appealed to the Arizona Board of Tax Appeals on March 26, 1993.

13. A hearing was held before the Arizona Board of Tax Appeals on December 7, 1993. At that hearing, the Department of Revenue waived its claims for late payment and negligence penalties and conceded the issue of the taxpayers' 1987 claimed dividend deduction.

14. On November 2, 1994, the Arizona Board of Tax Appeals entered its notice of decision upholding the Department's proposed assessment on the remaining issues.

15. Jurisdiction is proper in this Court pursuant to A.R.S. § 42-124(b)(2).

16. Basin's income from its timber activities is immune from tax by the State of Arizona because the authority of the State of Arizona to levy tax on the income from those activities has been held by the United States Supreme Court to be preempted by the comprehensive federal regulatory scheme for Indian timber, a scheme which the Supreme Court has held leaves "no room" for the levy of Arizona tax on Basin's income from its Indian logging activities.

17. Pursuant to Internal Revenue Code § 1366(b), the character of any item included in a shareholder's pro rata share of corporate Subchapter S income is to be determined "as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation." A.R.S. § 43-1126 creates an analogous Subchapter S provision for Arizona income tax purposes, and Arizona income tax statutes take federal taxable income as the basis for Arizona income.

18. Plaintiffs' allocable share of Basin's income from Indian timber operations is not subject to income tax by the State of Arizona.

19. Plaintiffs' allocable share of Basin's income for 1987 and 1988 is further not subject to Arizona income tax because the federal gain is based in part on recapture of depreciation deductions which were not previously deducted by Basin for purposes of Arizona income tax.

20. Plaintiffs are entitled to recover their expenses and reasonable attorneys' fees pursuant to A.R.S. § 12-348.

WHEREFORE, plaintiffs respectfully request that the Court:

A. Determine that the Department of Revenue's proposed income tax deficiency assessments for the plaintiffs for the years 1987 and 1988 are incorrect;

B. Determine that the taxpayers have no further Arizona income tax liability for the years 1987 and 1988;

C. Award plaintiffs their expenses and attorneys' fees incurred in this matter; and

D. Provide such other and further relief as the Court may deem proper in the premises.

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Supreme Court, U.S.
FILED
JAN 28 1999
CLERK

(2)

No. 98-1034

In The

Supreme Court of the United States

October Term, 1998

GARY LOVENESS AND ELIZABETH LOVENESS,

Petitioners,

v.

STATE OF ARIZONA, EX REL. ARIZONA DEPARTMENT OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Arizona Court Of Appeals, Division One

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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18 pp

QUESTION PRESENTED

Does federal law pre-empt the imposition of a net income tax on the income of non-tribal members who live outside any Indian reservation, but derive some income from reservation activities?

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SUPPLEMENTAL STATEMENT OF THE CASE

Gary and Elizabeth Loveness ("Taxpayers") are non-Indians. Pet. at 2. They were residents of Arizona in 1987 and 1988, residing in Pinetop, Arizona, outside the boundaries of any Indian reservation. CR 18, ¶¶ 2, 13.[1] During 1987 and 1988, Taxpayers' residence was within the jurisdiction of the State of Arizona and its political subdivisions. *Id.*, ¶ 14. The State and its political subdivisions, not the White Mountain Apache Tribe, provided governmental services (including law enforcement) at Taxpayers' residence. *Id.* 18, ¶¶ 14, 15, 16, 17. Taxpayers were registered to vote in the State of Arizona, and maintained their personal bank accounts in Pinetop, Arizona. *Id.* 18, ¶¶ 20, 21.

Taxpayers were shareholders and employees of Basin Building Materials Co., Inc. ("Basin"), which conducted business under the name of Pinetop Logging Company. *Id.* 18, ¶ 3. In traveling from their residence to their work during 1987 and 1988, Taxpayers used State, BIA, and tribal roads. *Id.* 18, ¶ 18. Between 1980 and 1986, the Arizona Department of Revenue ("Department") repeatedly notified Basin that it was subject to Arizona's income tax. In the face of Basin's claimed defenses, and in consideration of the risks of litigation, the Department did not take collection action against Basin, but it always plainly stated that its position was that the income tax was valid. (Plaintiffs' Statement of Facts, Ex. 12).

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[1] References to the record ("CR") are to the Clerk's Record supplied to Arizona Court of Appeals by the trial court.

Due to certain advantages in the federal tax law, in 1986 Basin elected to become an S Corporation for tax purposes. CR 18, ¶ 4. In general, the effect of an S Corporation election is that the income of the corporation is not taxed at the corporate level, but instead is taxed directly as the shareholders' income. Internal Revenue Code § 1361 *et seq.; see also* CR 18, ¶ 4.

Taxpayers received wages from Basin, and reported and paid Arizona tax on those salaries. *Id.* 18, ¶ 5. In 1987 and 1988, Taxpayers reported all of Basin's income on their federal income tax returns. *Id.* 18, ¶ 7. On their Arizona income tax returns, however, Taxpayers subtracted Basin's income from logging operations, the sale of assets, and, for 1987, interest income. Pet. at 3; CR 18, ¶¶ 6-11.

The audit section of the Department examined Taxpayers' 1987 and 1988 returns. CR 18, ¶ 12. Based upon this examination, assessments were issued for underpayment of taxes. *Id.* Taxpayers' subtraction from their income of their share of Basin's income was disallowed because Taxpayers are non-Indians, income taxes on non-Indians are not pre-empted by federal law, and their residence outside any Indian reservation gives the State authority to tax their income from all sources. *Id.*

Taxpayers misstate the record in their discussion of *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980), when they allege that the State agreed in 1969 that it had no jurisdiction to tax Basin's activities for the Tribe, but later reversed itself. Pet. at 4. The record shows that in 1969 the State Tax Commission advised Basin that Arizona's transaction privilege tax would not apply to its on-

reservation activities. (Plaintiffs' Statement of Facts, ¶ 8). The taxes at issue in *Bracker* were different taxes administered by a different agency. The personal income tax at issue here is distinct from either the transaction privilege tax or the taxes is dispute in *Bracker*, and the State has never informed either Basin or the Taxpayers that it does not apply.

THE COURT SHOULD DENY THE PETITION

Taxpayers are non-Indians who owned a business that performed contracting work for an Indian tribe. They assert that because some of their income is derived from on-reservation logging work for an Indian tribe, the State of Arizona cannot impose its personal income tax on them with regard to that income. The Department determined otherwise, treating them like any other individual taxpayer in Arizona, and assessed them for unpaid taxes. Because the income tax is imposed on non-Indians and is not a direct burden on any transaction with an Indian tribe, the Arizona income tax is not pre-empted by federal law and does not interfere with tribal sovereignty. The decision of the court of appeals was correct, and the Petition for Writ of Certiorari should be denied.

I. THE COURT OF APPEALS CORRECTLY HELD THAT *BRACKER* DID NOT REQUIRE THE PREEMPTION OF AN INCOME TAX IMPOSED ON NON-INDIANS LIVING OUTSIDE ANY INDIAN RESERVATION.

Taxpayers' argument that the court of appeals overruled this Court's decision in *Bracker* is simply wrong. The court of appeals carefully considered *Bracker* and persuasively concluded that it does not control in light of the very different facts of this case. Pet. App. at 6-11. In asking the Court to blindly apply *Bracker*, Taxpayers ignore one of the most important holdings of that case – namely, that rigid rules are not to be followed and each case must be examined independently. 448 U.S. at 144-5. Taxpayers asked the court of appeals to ignore this admonition, but it refused to do so and correctly considered the facts and legal context of this particular tax as applied to these particular taxpayers.

Bracker involved federal statutes regulating the sale of reservation timber owned by the tribe. *Id.* at 146-47. The BIA was authorized, and required, to manage the timber for the benefit of its owner and was authorized to determine the disposition of the proceeds from timber sales. Arizona imposed the state taxes at issue on a nonmember contractor hired by the tribe to harvest timber in return for a contractually specified fee. *Id.* at 139. The tribe agreed to reimburse its contractor for any tax liability incurred as a result of its on-reservation activities. *Id.* at 140. The Court held that the federal regulatory scheme was "so pervasive as to preclude the additional burdens sought to be imposed in this case." *Id.* at 148. In reaching this holding, the Court noted that the federal

government was responsible for reviewing and approving the contracts between the tribe and its contractors, and that the direct economic burden of the asserted taxes would fall on the tribe. *Id.* at 149, 151.

The court of appeals properly rejected Taxpayers' claim that *Bracker* required a finding that their income is not subject to state tax. The court of appeals distinguished *Bracker* because it involved a different type of tax:

> The taxes in *Bracker*, and in all of the lower court cases upon which taxpayers rely, were taxes assessed on activities that occurred in Indian country. The character of these taxes was central to the *Bracker* analysis. *See* 448 U.S. at 148, 150-51. They affected the cost of logging, impacted the federal regulatory scheme, and eventually took money away from the tribe in circumvention of Congress' intent. . . .
>
> No support beyond speculation exists for the view that any part of the income taxes assessed here imposed a direct economic effect on the tribe, undermined the tribe's interests, or limited federal policies advancing the comprehensive regulatory scheme pertaining to tribal timber harvesting and management. . . . Thus, the difference in the tax assessed is significant enough to distinguish this case from *Bracker*.

Pet. App. at 7, 9.

The Arizona income tax is imposed on the entire taxable income of every resident and on income of nonresidents derived from within the State. Arizona Revised Statutes ("A.R.S.") § 43-1011. The tax is not imposed on

the gross receipts of the taxpayer, but allows for deductions for expenses, dependents, and numerous other items. A.R.S. §§ 43-1021-1043. Thus, the amount paid by an employer, customer, or any other source does not determine the tax liability of the taxpayer, because unrelated expenses or losses must first be considered. This is significantly different than a tax imposed on gross receipts or gross income, such as those at issue in the cases cited by Taxpayers. An income tax does not directly burden the employer, customer, or other source of income. *See New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937) (tax on an employee's income is not the equivalent of a tax on the employer). Nor is the "net income" of a non-Indian doing business with a tribe subject to any of the federal regulatory schemes at issue in the cases cited by Taxpayers. Those federal regulations may control the amount a non-Indian may charge a tribe, but none of them purport to regulate the profit or taxable income of the non-Indian.

The present case does not involve the State reaching into the reservation to impose its tax on on-reservation activities involving a tribe or tribal members. It involves a personal income tax imposed on Arizona residents who do not live on a reservation, and whose tax liability is not directly related to any transaction with the tribe. Unlike *Bracker*, where the motor carrier tax directly burdened the on-reservation commercial transaction between the taxpayer and the tribe, the net income tax is imposed on Arizona residents based upon their income, from whatever source. In *Bracker*, the imposition of the tax directly increased the charge to the tribe, and indeed the tribe had agreed to reimburse Pinetop Logging for any tax liability

incurred as a result of its on-reservation business activities and intervened in the case. 448 U.S. at 140. Here, there is no evidence that the income tax imposed on Taxpayers would be directly passed on to the tribe. While the forest regulations relied upon in *Bracker* control to a great degree the actual activity of harvesting the timber, they provide no evidence of intent to remove all barriers to profit maximization, including indirect barriers such as income taxes on non-Indians doing business with tribes.[2] Moreover, in *Bracker,* this Court found that the State was "unable to identify any regulatory function or service [it] performed . . . that would justify the assessment of taxes for activities on Bureau and tribal roads within the reservation." 448 U.S. at 148-9. The Court also found that it was undisputed that the economic burden of the taxes ultimately fell on the Tribe. *Id.* at 151. Neither of these factors are present here, where the Taxpayers are recipients of State services at their home off-reservation and any tax on their income is based on their taxable income, not their gross receipts from any particular job.[3]

Taxpayers' attempt to equate the existence of a federal regulatory scheme with congressional intent to preempt any state taxation of its activities is plainly contrary

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[2] Taxpayers point to no federal statutes or regulations that regulated their company's sale of equipment, earning of interest income, or profits. It cannot seriously be argued that these activities are covered by federal timber regulations, or by the Supreme Court's holding in *Bracker.* Absent federal law regulating an activity, there is no pre-emption.

[3] Taxpayers are the direct beneficiaries of state services and regulations through their domicile within the State of Arizona, especially at their residence outside any reservation.

to this Court's decisions in *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 180 (1989) and *Department of Revenue and Taxation v. Milhelm Attea & Bros., Inc.*, 512 U.S. 61 (1994). *Cotton Petroleum* involved a challenge to a state severance tax on the production of oil and gas on an Indian reservation. *Cotton Petroleum*, 490 U.S. at 156. The mineral leases in *Cotton Petroleum* were subject to federal regulation at least as comprehensive as that present in *Bracker*, yet this Court upheld the state tax. The Court emphasized that the primary burden of the tax was on non-Indians, *id.* at 187 n.18, and that federal regulation was not exclusive because the nonmember taxpayer was also subject to state law. *Id.* at 186. The Court distinguished *Bracker* as involving complete abdication or noninvolvement of the State in the taxed activities and taxes that were passed on to the tribes. *Id.* The Court rejected the argument that a state can only impose taxes proportionate to the services provided to the taxpayer. *Id.* at 185.

In *Milhelm Attea*, the Court also rejected the argument that comprehensive federal regulation of on-reservation activities inevitably leads to pre-emption of any state tax on those activities. 512 U.S. at 70-78. In that case enrolled tribal members purchased cigarettes and resold them to nonmembers. *Id.* at 64-65. The State of New York adopted regulations to require that wholesalers precollect state tax on sales intended for resale to nonmembers. *Id.* The taxpayer challenged the regulations as being pre-empted by the federal Indian Trader Statutes, 25 U.S.C. § 261 *et seq.*, because the regulations imposed actual burdens on sales to tribal members. *Id.* at 67-69. This Court rejected that challenge, noting that "[a]lthough language in *Warren Trading Post* [*v. Arizona Tax Commission*, 380 U.S. 685

(1965)] suggests that no state regulation of Indian traders can be valid, our subsequent decisions have 'undermine[d]' that proposition." *Id.* at 71 (quoting *Central Machinery Co. v. Arizona State Tax Comm.*, 448 U.S. 160, 172 (1980) (Powell, J., dissenting)). The Court found the purpose and effect of State regulation was to impose taxes on nonmembers, and that the State had not sought to control "the kind and quantity of goods and the prices at which such goods shall be sold to the Indians." *Id.* at 75 (quoting 25 U.S.C. § 261). The Court looked beyond the bare existence of comprehensive federal regulation, and found no congressional intent to bar state taxes ultimately borne by nonmembers.

Cotton Petroleum and *Milhelm Attea* illustrate that comprehensive federal regulation of a reservation activity is not enough to pre-empt a tax on nonmembers doing business on an Indian reservation. One of this Court's most recent decisions relating to state taxation on reservations reinforces this point. In *Montana v. Crow Tribe*, 118 S.Ct. 1650, 1652 (1998), this Court described *Cotton Petroleum* as a "pathmarking decision," and stated:

> *Cotton Petroleum* clarified that neither the IMLA, nor any other federal law, categorically preempts state mineral severance taxes imposed, without discrimination, on all extraction enterprises in the State, including on reservation operations. "Unless and until Congress provides otherwise, each of the . . . two sovereigns [– State and Tribe –] has taxing jurisdiction over all [on-reservation production]."

Id. at 1660.

Bracker involved a statutory scheme that this Court interpreted as implicitly and unequivocally barring any state taxes imposed on transactions with tribes when the tax will plainly have to be paid out of the contractor's receipts of tribal funds. *Cotton Petroleum* and *Milhelm Attea,* on the other hand, involved state taxation of on-reservation transactions where the tax was not directly passed on to the tribe. In all three cases there were economic effects on the tribe and comprehensive federal regulation, but federal pre-emption existed only when the effect of barring the state tax was to protect tribes and their members from direct and substantial effects of state law. There is no federal pre-emption when the primary effect is to protect nonmembers.

Federal law regulates timber harvesting on Indian reservations. It does not regulate the amount of profit to be made by tribal contractors, the sale of assets by tribal contractors, or the interest earned on their bank accounts. *Bracker* does not hold to the contrary. The narrow issue decided in *Bracker* was whether the State could impose taxes which directly burdened the transactions between non-Indian contractors and the tribe. As the court of appeals correctly concluded, *Bracker* did not hold that the State could not impose any burdens on those non-Indian contractors which might have indirect effects on the tribe.

Moreover, it is important to note that *Bracker* did not hold that all of the non-Indian contractors' activities were immune from the state fuel taxes, but only its activities on Bureau of Indian Affairs and tribal roads. *Bracker,* 448 U.S. at 140, and note 6. Taxpayers conceded in *Bracker* that they were taxable to the extent of their on-reservation activities on state roads. Taxpayers' argument that

Bracker held that any burden on the contractors was pre-empted is simply not supported by the decision.

Taxpayers' reliance on *Hoopa Valley Tribe v. Nevins*, 881 F.2d 657 (9th Cir. 1989) (Petition at 12-13) is similarly misplaced. In *Hoopa Valley*, the Ninth Circuit specifically noted that the state tax directly burdened the tribe. *Id.* at 658 ("Standard timber industry practice is for the timber owner to bear the economic burden of timber taxes imposed on timber purchasers."). Moreover, the history of the timber tax showed that it was intentionally crafted to tax timber that would otherwise be tax exempt. *Id.* Here, the state income tax is not a direct burden on any Indian tribe and the State's plain intention is to tax Arizona residents on their income from whatever source.

In summary, *Bracker* involved only on-reservation activities, and did not consider whether federal pre-emption affected an income tax. The cases that have considered income taxes, and particularly income taxes on off-reservation residents, have found the state has authority to impose its tax. Therefore, the court of appeals correctly held that *Bracker* does not require the pre-emption of a State income tax imposed on non-Indians residing outside any reservation.

II. FEDERAL LAW DOES NOT PRE-EMPT A STATE INCOME TAX IMPOSED ON A NON-INDIAN WHO RESIDES OUTSIDE ANY INDIAN RESERVATION.

Taxpayers' argument that the state income tax is pre-empted also fails because Taxpayers are not tribal members and do not live on a reservation. State laws generally

apply to non-Indians on a reservation, even when such a law could not apply to a tribal member, and "a State can impose a nondiscriminatory tax on private parties with whom the United States or an Indian tribe does business, even though the financial burden of the tax may fall upon the United States or tribe." *Cotton Petroleum*, 490 U.S. at 176. Although Congress reserves the right to bar state taxes, if Congress has not acted to grant such immunity "either expressly or by plain implication," *id.* at 175-6, there is no pre-emption. Determining whether federal legislation has pre-empted state taxation is primarily an exercise in examining congressional intent, and the history of tribal sovereignty serves as a necessary "backdrop" to that process. *Id.* at 176. An income tax imposed on a non-Indian, even one doing business with a tribe, simply does not infringe on tribal sovereignty.

The lower courts have consistently rejected challenges to personal income taxes by non-tribal members. *Kahn v. Arizona State Tax Commission*, 16 Ariz. App. 17, 490 P.2d 846 (1971), *appeal dismissed*, 411 U.S. 941 (1973); *Chickasaw Nation v. State of Oklahoma*, 31 F.3d 964 (10th Cir. 1994), *aff'd in part, rev'd in part*, 515 U.S. 450 (1995); *Sac and Fox Nation v. Oklahoma Tax Commission*, 967 F.2d 1425 (10th Cir. 1992), *vacated on other grounds*, 508 U.S. 114 (1993); *New Mexico Taxation & Revenue Department v. Greaves*, 864 P.2d 324 (N.M. App. 1993).

In the present case, Taxpayers' residence off-reservation makes it even more evident that the Arizona income tax is due. Even tribal members are generally subject to state taxes outside reservations. *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148-9 (1973).

The validity of an income tax on off-reservation residents was recently decided by this Court in *Oklahoma Tax Com'n v. Chickasaw Nation*, 515 U.S. 450 (1995):

> We further hold, however, that Oklahoma may tax the income (including wages from tribal employment) of all persons, Indian and non-Indian alike, residing in the State outside Indian country. The Treaty between the United States and the Tribe, which guarantees the Tribe and its members that "no Territory or State shall ever have a right to pass laws for the government of" the Chickasaw Nation, does not displace the rule, accepted interstate and internationally, that a sovereign may tax the entire income of its residents.

Id. at 453. The Court's reference to the Treaty is particularly relevant here, because the Treaty must have as much pre-emptive effect as the federal regulation of timber harvesting, yet the Court held it did not reduce the State's power to tax off-reservation residents on all their income.

Taxpayers' attempt to distinguish *Chickasaw Nation* as only involving the "categorical" rule that Indians are not exempt outside Indian country (Petition at 15) fails in the face of this Court's rejection of the Treaty as grounds for pre-emption. *Chickasaw Nation* shows that federal treaties and statutes that govern on-reservation activities will not be construed to impliedly pre-empt a state income tax imposed on off-reservation residents. A State resident who lives outside any Indian reservation is subject to State income tax, even on income earned on a reservation.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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Supreme Court, U.S.
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(3)

No. 98-1034

In The

SUPREME COURT OF THE UNITED STATES

October Term 1998

GARY LOVENESS and ELIZABETH LOVENESS,

Petitioners

v.

STATE OF ARIZONA, ex rel.
ARIZONA DEPARTMENT OF REVENUE,

Respondent

On Petition for Writ of Certiorari
To the Arizona Court of Appeals, Division One

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Respondent would recast the question as whether federal law pre-empts net income taxes on non-Indians "who live outside any Indian reservation, but derive some income from reservation activities," as though this case had nothing to do with the specifically preemptive federal Indian timber laws. No such question has ever been posed in this case. Federal law does not exclude state taxes on income of non-Indians merely because earned in Indian country, even when they live in Indian country. *Kahn v. Arizona State Tax Comm.*, 16 Ariz. App. 17, 490 P.2d 846 (1971), *appeal dismissed*, 411 U.S. 941 (1973).

Respondent's recasting of the question has some proximity to one branch of what the Arizona Court of Appeals actually did in this case—allow off-reservation domicile to trump an otherwise preemptive federal scheme. The parties appear to concur that at least part of the issue is whether domicile alone has primacy over preemptive federal language and purposes, to which domicile is irrelevant.

Respondent errs in omitting the question of the supposed conflict between *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989), and *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980), which was an explicit ground of the decision below. Pet. App. at 8.

REASONS TO GRANT THE PETITION

1. Respondent Accepts the Statements of the Case and of the Facts in the Petition.

With the exception of its denial of adverse economic effect, refuted by the stipulated facts, Respondent accepts the statements of the case and of the facts in the Petition. The stipulated record favors certiorari in this case.

Indeed, by stipulation of the parties, "Pinetop Logging's activities" in this case were presented below as a factual replica of *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980), "insofar as relevant to federal

preemption of state taxation by federal timber regulation." Facts ¶ 8(f). The only difference was the gross income tax in *Bracker* and the net income tax in this case. This stipulation, nowhere acknowledged in the Brief in Opposition, stops Respondent from saying that this tax is not a burden on the Tribe or on the explicit federal purpose "that the Indians may receive from their Indian forest land . . .the benefit of all the labor and profit that such Indian forest land is capable of yielding." 25 C.F.R. 163.3(b)(4).

Additional circumstances showing such practical burden are summarized in the stipulated Statement of Facts. Facts ¶ 8 (contract prices between Pinetop and the Tribe were negotiated in light of all costs to Pinetop, including taxes; contract terms shifting tax burdens from Pinetop to the Tribe were included in 1973 after the gross income taxes were assessed, though omitted at the outset because thought unnecessary; tax indemnification again omitted after the *Bracker* decision because again thought unnecessary; Pinetop terminated business relation with Tribe in 1988, so when income taxes were first assessed in 1990 Pinetop lacked business relationship from which to obtain indemnification as it had in 1973).[1]

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[1] Respondent notes that in 1969 the State advised Pinetop Logging Company that the transaction privilege tax would not apply to Pinetop's proposed logging for the While Mountain Apache Tribe (Facts ¶ 8) and then asserts, "The personal income tax at issue here is distinct from either the transaction privilege tax or the taxes in dispute in *Bracker*." Br. Opp. at 2-3. The Arizona transaction privilege tax is a gross income tax on numerous types of business. Ariz. Rev. Stat. §§ 42-1301 *et seq.* Motor carriers are taxed on their gross income under a special statute with a special name ("motor carrier fee"). Ariz. Rev. Stat. §§ 28-5851 *et seq.* The reference to transaction privilege tax in the 1969 correspondence was plainly short hand for the gross income tax on motor carriers, which was substantively identical to the transaction privilege tax of general application.

2. Whether *Bracker* Was Overruled, Even in Part, by *Cotton Petroleum Corp. v. New Mexico* Warrants Certiorari.

The Brief in Opposition joins issue on whether recent cases have changed implied Indian preemption in general and *Bracker* in particular to the point of yielding different outcomes. Respondent first acknowledges:

> *Bracker* involved a statutory scheme that this Court interpreted as implicitly and unequivocally barring any state taxes imposed on transactions with tribes when the tax will plainly have to be paid out of the contractor's receipts of tribal funds.

Br. Opp. at 10. But Respondent now argues for a bright-line rule that preemption cannot be found "where the tax was not directly passed on to the tribe" and "that comprehensive federal regulation of a reservation activity is not enough to pre-empt a tax on nonmembers doing business on an Indian reservation." Br. Opp. at 9-10.

The cases it cites do not support Respondent. *Department of Revenue and Taxation v. Milhelm Attea & Bros, Inc.* 512 U.S. 61, 73 (1994), upheld record-keeping and other "minimal burdens reasonably tailored to the collection of valid taxes from non-Indians." The cigarette taxes themselves on the non-Indians were undisputedly lawful, and the reservation retailers were attempting to profit from assisting non-Indians in evading them. As noted in the Petition at 10-12, *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989), held the Mineral Leasing Act of 1938, a statute lacking most of the elements of preemption found in *Bracker*, not preemptive in the first place. Mere indirect economic effect of the state tax (or even direct effect) on the tribe without an articulated preemptive federal purpose was insufficient to defeat the state tax.

Elsewhere Respondent is less forthright about its accomplishment below. The lower court agreed with Respondent that *Bracker* is no longer good law according to its

terms: "since *Bracker* the Supreme Court has modified the way it analyzes possible negative financial effects on individual Indians or their tribes when a tax is challenged by non-Indians conducting on-reservation activities." Pet. App. 7-8.

Now Respondent says the court of appeals found no overruling of *Bracker* but merely "concluded that [*Bracker*] does not control in light of the very different facts of this case." Br. Opp. at 4. The court of appeals had no such misapprehension about its holding; it assessed the facts under standards admittedly different from those employed in *Bracker*. Pet. App. at 8. Moreover, as noted above, the relevant facts are stipulated as identical to those of *Bracker*. Facts ¶ 8. Under that stipulation *Bracker* can be avoided only if *Bracker* has been changed.

Respondent's distinctions on *Bracker* merely highlight the conflict between *Bracker* and the decision below. Respondent restates the Arizona Court of Appeals' holding, resurrecting its 1978 reasoning rejected in *Bracker*, that the technical incidence of the tax under state law forgives its adverse effect on the federal purposes. Br. Opp. at 5-6. Though it is stipulated that the taxed income is for hauling tribal logs on tribal and BIA roads (Facts ¶ 5), Respondent would divorce the tax from the logging and from the roads by force of words alone ("any tax on their income is based on their taxable income, not their gross receipts from any particular job," Br. Opp. at 7). Respondent would also distinguish *Bracker* on the ground that "Taxpayers are recipients of State services at their home off-reservation" (Br. Opp. at 7), though that was also true in *Bracker*.

C. Off-Reservation Domicile Does Not Defeat Timber Preemption.

Respondent acknowledges the court of appeals' alternative holding that timber preemption ceases if the non-Indian agent of the tribe chosen as the object of the State's tax is domiciled out of Indian country. Br. Opp. at 11-13; Pet. App. 9-11. But Respondent's brief does not address the significance of off-reservation domicile for the timber

preemption recognized in *Bracker*. Instead it batters a straw man, demonstrating that off-reservation domicile generally warrants state income taxes on non-Indians and Indians alike. Br. Opp. at 12-13. This case is about the preemptive effect of the Indian timber laws specifically. Neither Respondent nor the court below offered any reason to oust timber preemption on the chance that non-Indian agents of protected tribal timber programs are domiciled off-reservation.

Oklahoma Tax Comm. v. Chickasaw Nation, 515 U.S. 450 (1995), held only that a treaty term unrelated to the Federal Indian timber laws did not generally preempt state power to tax income of state domiciliaries. Petitioners claim no general immunity from state income taxation, only immunity for income from hauling tribal timber on tribal and BIA roads for a tribal timber enterprise. If off-reservation domicile alone defeats such preemption, both the doctrine and the results of many cases on implied federal preemption of state laws for the benefit of Indians are overturned. That result merits certiorari.

CONCLUSION

The Petition of Writ of Certiorari should be granted.

Respectfully submitted,

February 23, 1999

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